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THE MARKET MANIPULATION REGIME IN THE EUROPEAN UNION

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Introduction

The importance of financial market in modern economy is self-evident. It, on the one hand, serves as a platform that provides accesses for one group of market participants to invest surplus funds, and on the other hand, offers more opportunities for the other group with pressing need of money to raise capital. In an efficient capital market, prices of investment instruments always “fully reflect” available information.¹ However, this efficiency could be undermined by abusive practices, such as misappropriating unreleased price-sensitive information, distorting the demand and supply patterns, and manipulating information. These practices, through disturbing the price formation mechanism, will lead to inefficient allocation of capital resources and undermine the smooth functioning of the financial market.

Abusive practices are recognized as market abuse under EU legislation, mainly covering insider dealing (or insider trading) and market manipulation, which are the big destroyers and potent enemies for financial market.² Although insider dealing and market manipulation are commonly mentioned together given their damage to the market integrity and investor confidence, they share few aspects in common. Insider dealings are illegal practices that insiders, on the basis of precise, material, non-public and related information,³ purchase or sell one or more financial instruments or encourage other investors to do so. The core element is “inside information”. While market manipulation concludes a wider range of behaviours, which create an unfair, artificial and distorted appearance of a security’s price on the market.⁴ And compared with insider dealing, manipulative practices are neither discussed exhaustively nor having a widely accepted and clear definition.

¹ Eugene F. Fama, “Efficient Capital Markets: A Review of Theory and Empirical Work”, *The Journal of Finance*, Vol. 25, No. 2 (May 1970), pp. 383-417. Eugene F. Fama, “Efficient Capital Markets: II”, *The Journal of Finance*, Vol. 46, No. 5 (Dec., 1991), pp. 1575-1617.

² Emiliós Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, (Oxford University Press, 2005), p. 4.

³ These four criteria are the basis for judging inside information in EU law. See Market Abuse Directive, Article 1 (1).

⁴ Emiliós Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, p. 4.

Market manipulation is generally prohibited in the worldwide financial markets. Its regulation could be traced back to the eighteenth century in Europa, which is proved by relating legislation, such as the Decree of the 24 September 1724 in France, the “Bubble Act” in 1720 in the UK, and the Imperial Decree of 1 August 1771 in German.⁵ In recent years, given the harmonization of European financial markets, market manipulation regulation in EU countries has become predominantly European-based, with EU directives being the predominant source of the Law.⁶ As a result, an EU market manipulation regime is established to efficiently tackle manipulative offences, mainly by the 2003 Market Abuse Directive and four supporting administrative rules.

Although the current market manipulation regime is broadly considered as a great success, there are still many issues concerning its enforcement and supervisory inconsistency in the EU. A review of this regime was carried out at the end of 2007, which quickly became incorporated within the wider EU crisis-era reform programme.⁷ In 12 July 2014, the new regulatory package, Market Abuse Regulation and Directive on criminal sanctions for market abuse, was adopted, which will fulfil the regulatory gaps of the current regime, and enhance the efficiency of supervision and enforcement. The new legislations will contribute to a further harmonisation of the EU market manipulation regulation.

The thesis focuses on the analysis of the EU market manipulation regime. Specifically, it examines whether the current market manipulation regulation sufficiently prevent manipulative practices, states the reasons why a reform of current regime has been made, and analyses the main refinements set out in the new regime. In addition, this thesis also tries to make refinements of the Chinese market manipulation regime by drawing on experiences of the EU regime.

⁵ Marco Lamandini, “Handbook of European Capital Markets Regulation (An Introduction and a Reasoned Collection of Official Materials)”, Volume 1, (Libreria Bonomo Editrice, September 2011), pp.15-19.

⁶ Mathisa M. Siems, “The EU Market Abuse Directive: A Case-Based Analysis”, *Law and Financial Markets Review*, Vol. 2, No. 1, 2008, pp. 39-49.

⁷ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press, 2014, p. 710.

The thesis is divided into six chapters. Chapter 1 analyzes the legal and economic rationales of market manipulation. The nature and damages of market manipulation could be explained by the theories of Efficient Capital Market Hypothesis (ECMH) and behavioral finance. Market manipulation is hard to define, and a general review of definitions provided by legislators, judges and experts is made. Also, the commonly recognized types of manipulation, (information-based manipulation, manipulations based on artificial transactions, and trade-based manipulation) are described in this chapter, supporting by numerous typical examples.

Chapter 2 is dedicated to examine the legal framework of market manipulation regime under the 2003 Market Abuse Directive. Firstly, it describes the legal resources of EU market manipulation regulation, which include Market Abuse Directive, second-level implementing directives and third-level guidelines by CESR (now ESMA). Secondly, the regulation of three main types of manipulative practices is analyzed in detail respectively. Thirdly, the liability regime, as a deterrence of market manipulation, is discussed here. A detailed analysis of the constituent elements of different liabilities and their justifications is also offered in this chapter.

Chapter 3 and Chapter 4 seeks to explore the reasons why the EU market manipulation (or market abuse) regulation need to be reviewed and the main changes after the reform. Significant changes of trading venues and financial products in the EU, divergences in supervision and enforcement, and lack of clarity and legal certainty are the main reasons that lead to the review of market abuse regulation in EU.

As regards to the changes, they can be summarized into two facets: on the one hand, a framework reform is made. Regulation will take the place of directive to provide a higher uniform and directly binding market manipulation regime. And on the one hand, substantive changes are also made relating to widen the scope of the regime, to add new prohibition, to refine derogations, and to enhance efficiency of supervision and enforcement.

Chapter 5 provides an assessment of the balance between the prohibition of market manipulation and protection of fundamental rights. It points out the types of fundamental rights that are easily affected by the market manipulation regime, and the conditions that should be satisfied if limitation is made to fundamental rights.

And Chapter 5 explains the reasons why market manipulation has been such a serious problem in the Chinese financial market, and the major and special characters of the manipulative activities. It also analyzed the main issues that existing in the Chinese manipulation regime, providing several suggestions that are studied from the EU experiences of market manipulation, to refine the Chinese system.

Chapter 1 A Principled Analysis of Market Manipulation

Market manipulation could make serious damages to the capital market. It is considered as a basic cause of market crashes.⁸ Manipulative behaviours, however, are very complex and have many derivative forms. For a better regulation, it is necessary to make a good analysis of its nature and composition.

1.1 Defining market manipulation

Manipulation, in ordinary usage, is “to manage or control artfully or by shrewd use of influence, often in an unfair or fraudulent way”⁹. Commercial data, information, facts and figures could all be used by “manipulator” to realize his aim, no matter good or evil.¹⁰ When manipulation is referred in capital market, practices, which exploit financial strength, stock holdings, information or reputation advantages, may all be considered as “manipulative”.¹¹

However, if market manipulation is simply defined so, not only harmful abusive acts but also social desirable conducts are included. For instance, after close study of a company, several economic students buy many stocks of that company in the belief that the price of that stock is going to raise. They may share their analysis with their friends and also recommend them to buy. After the price rises to certain level, these people may have a negative attitude towards the stock and then sell them. Yet there is nothing to blame those students for the profits that they made through these transactions, because this is how the market works.

⁸ Comment, “Regulation of Stock Market Manipulation”, *Yale Law Journal*, Vol. 56, No. 3, (Feb. 1947) pp. 509-533, p.509.

⁹ David B. Guralnik ed.-in-chief, *Webster's New World Dictionary of the American Language*, Prentice Hall Press, 2d ed, 1986, p. 862.

¹⁰ Jason Pickholz and Marvin G. Pickholz, “Manipulation, *Journal of Financial Crime*”, 2001, J.F.C. 2001, 9(2), pp.117-133, p.118.

¹¹ Like the stabilization made by market maker or “poison pills” “white knights” and other defending plans used during corporate merger.

Market manipulation is a concept hard to define, in view of the widely varying types of devices used to stimulate or to discourage the buying and selling of securities.¹² As a result, market manipulation is defined differently according to the approach chosen. Hardly any definition of market manipulation is satisfying or popularly accepted,¹³ mainly for the reason that statutes normally do not prohibit market manipulation by name, only describing its various forms. For example, Article 397 of the UK Financial Services and Markets Act (FSMA 2000) provides misleading statements and practices without mentioning “market manipulation”.¹⁴ However, this situation changed with the coming into force of Market Abuse Directive¹⁵ in European Union (EU) in 2003. This EU legislation explicitly forbids market manipulation using this name, and tries to give a legal definition together with two implemented directives and three guidelines.¹⁶ It is a great contribution that EU legislations clarify the concept of market manipulation.

Despite frustrated by the unpleasant situation in legislative aspect, legal scholars, judges and economists have made many attempts to defining market manipulation, which helps to sketch a fairly complete picture of what market manipulation is. Arguably, four approaches are explored in defining market manipulation in economic theory and relevant statutory and regulatory texts: the primary two are “effects-based approach” (also named artificial price) and “intent-based approach”; the third one is “combined approach”, a combination of the former two approaches; and the last approach is “market power”.¹⁷

¹² Comment, “Regulation of Stock Market Manipulation”, the *Yale Law Journal*, Vol. 56, No. 3 (Feb., 1947), pp. 509-533.

¹³ Daniel R. Fischel and David J. Ross, “Should The Law Prohibit ‘Manipulation’ in Financial Markets?” (1991) 105 *Harv. L. Rev.* 503, pp.503-553, p. 506; Emiliios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, Oxford University Press (2005), p. 104; Söderström, Rebecca, “Regulating Market Manipulation: An Approach to designing Regulatory Principles”, (2011) p. 9, available at <http://uu.diva-portal.org/smash/record.jsf?pid=diva2:398256>, last visited on 23 Feb 2015.

¹⁴ Emiliios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, p.105.

¹⁵ Market Abuse Directive refers to “Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)”.

¹⁶ Market Abuse Directive, Article 2 and 5.

¹⁷ Emiliios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, pp. 107-108; Diego Leis, “High Frequency Trading: Market Manipulation and Systemic Risks from an EU Perspective”, February 2012, available at: <http://ssrn.com/abstract=2108344>, last visited on 5 March 2015.

1.1.1 Effects-based approach

The centre element of “effects based approach” is creation of artificial prices and/or false or misleading impressions regardless of the causation. Many definitions of market manipulation provided by commenters are based on this approach. For example, an older frequently cited definition of market manipulation: “*any and every operation or transaction or practice, the purpose of which is not primarily to facilitate the movement of commodity at prices freely responsive to the forces of supply and demand; but on the contrary, is calculated to produce a price distortion of any kind in the market*”.¹⁸ Another classic definition used by judges in the well-known case *Cargil Inc v. Hardin*, defined market manipulation as any activity, scheme or artifice that deliberately influences the price of a financial asset, resulting in a price other than the one that would have resulted in the absence of such intervention.¹⁹ And this is the approach that EU legislation has chosen to define market manipulation.

Two criteria are crucial in the “effects-based approach”. The first one is creating false or misleading impressions about the state of offer and demand or price of an investment instrument. The test standard employed here is “reasonable person” or “regular user”²⁰, which means that false or misleading impression is made if a manipulator’s practices influence or change an average investor’s original perception of market conditions and then induce him to make the investment decision expected by manipulators.

¹⁸ This definition is given by was given by A. Marsh, former president of the New York Exchange, in 1928 before a US Senate hearing examining the possible occurrence of manipulation in the US cotton futures. See Emilius Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, pp. 105-106, note 16: 1982 Senate Hearings 503.

¹⁹ *Cargill Inc. v Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972). Other judgment, like in *General Foods Corp. v Brannon*, 170 F.2d 220, 231 (7th Cir. 1948), judges defined manipulation as “the creation of an artificial price by planned action”. Same approach also could be found in the case *United States v Regan*, 937 F.2d 823 (2d Cir. 1991).

²⁰ “Regular user” is the standard used by the UK, “*the regular user is a hypothetical reasonable person who regularly deals on the market and in the investments of the kind in question or bids on the auction platform in relation to investments of the kind in question.1 The presence of the regular user imports an objective element into the elements listed in MAR 1.2.15 UK while retaining some subjective features of the markets for, or the auction of, the investments in question.*” Financial Conduct Authority (FCA), MAR 1.2.20, 01/04/2013, available at <http://www.fshandbook.info/FS/html/FCA/MAR/1/2>, last visit at 26/05/2013.

The other criterion used in this approach is “creation of artificial prices”. Yet this criterion is quite problematic. “Artificial price” is a vacuous expression and is also very hard to prove. It was described as the price that does not “reflect basic forces of supply and demand” by judges in an US case²¹. However, further confusion about “basic forces” (or “market forces”) is raised. So the US Supreme Court, by its decision in case *Schreiber v Burlington Northern Inc.*²² in 1985, disapproved use of the word ‘artificial’ as a legal standard because of the uncertainty created by its usage, even so courts in the US does not stop using this term.²³

An alternative way to exam “artificial price” focuses on “whether the trading moves prices are closer to or away from their correct level”, and “correct level” means that price reflects the long-run conditions of supply and demand.²⁴ Nevertheless, this test is not perfect because manipulation could also happen when moving the price away from short-run correct level. In 2000, the International Organization of Securities Commission (IOSCO) tried to provide a commonly accepted definition of “price artificiality”, which it describes as “the divergence of price from the legitimate forces of supply and demand.”²⁵ Unfortunately, there is a further trouble concerning the explanation of “legitimate forces”.

Hence, criticisms of using the inclusive concept of “artificial price” as a factor that provides conclusive evidence of market manipulation are made by scholars. They argued that all attempts to define this concept have been proved ineffective, as courts are obliged to do “unreasonably complex analysis of the markets and of the prevailing economic

²¹ *Cargill Inc. v Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972).

²² *Schreiber v Burlington Northern Inc.*, 472 U.S. 1, 7-8 (1985), p. 12.

²³ See Jason Pickholz and Marvin G. Pickholz, pp. 118-121.

²⁴ Fischel and Ross, p.509.

²⁵ Technical Committee of the International Organization of Securities Commission, “Investigating and Prosecuting Market Manipulation”, May 2000, p. 13. (Hereinafter IOSCO, “Investigating and Prosecuting Market Manipulation”, 2000)

conditions that make the legal prohibition practically inapplicable.”²⁶ As a result, some people turned from objective way to subjective method to define market manipulation.

1.1.2 Intent-based approach

In the “intent-based approach”, the heart of defining market manipulation is the subjective intent of alleged manipulators. This approach concentrates on traders’ conducts, avoiding the laborious job of proving the creation of an artificial price. Professors Fischel and Ross once claimed that no objective definition of market manipulation makes sense, so its definition should focus on the intent of the trader, defining as “profitable trades made with ‘bad’ intent”.²⁷ Accordingly, even a trader’s practices have the effects of rigging security price, he should not be treated as illegal manipulator unless evidences are provided to prove his “bad intend”.

“Intent-based approach” is adopted by legal definitions of market manipulation in many states. Proofs, which show manipulators’ intents to induce unsuspecting investors to trade for realizing his manipulative plan, are required, especially in the situation of imposing criminal sanctions on manipulators. For instance, in section 397 (2) (to some extent) and section 397 (3) of FSMA 2000, the approach explored is “intent-based approach”.²⁸ However, this approach has its own disadvantages as well. Since intent is a mental state, it is not easy to testify. Thus, there is a risk that conducts with “good intent” to influence an instrument’s price, which are illegal, could also be caught following this approach.

²⁶ Emiliios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, p. 112; W.C. Perdue, “Manipulation of Futures Markets: Redefining the Offense”, (1987) 56 *Fordham Law Review* 345, pp. 348,393 and 399-401.

²⁷ Fischel and Ross, p. 510.

²⁸ Part XXVII 397 (2): A person to whom subsection (1) applies is guilty of an offence if he makes the statement, promise or forecast or conceals the facts ***for the purpose of inducing, or is reckless as to whether it may induce, another person*** (whether or not the person to whom the statement, promise or forecast is made)...

(3) Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so ***for the purpose of creating that impression and of thereby inducing another person*** to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments.

1.1.3 “Combined approach” and “market power approach”

In terms of “combined approach”, it is a combination of the former two approaches, requiring both objective and subjective elements. Price artificiality and intent are both necessary elements. This approach is the choice of US securities legislation²⁹ and its courts. Taking the case *United States v Russo* for example, the jury was given the instruction by judges that, in order to find a manipulation, they “*must find that the defendant intended to raise the price of the stock to or maintain the price of the stock at an artificial level...*”³⁰

In terms of “market power approach”, the emphasis is manipulators’ ability to acquire control of a large part of the supply or demand of a financial instrument or physical commodity, and then to exercise his control of to “position” the price of that instrument to the level that best fits his benefits.³¹ “Cornering the market” and “abusive squeeze” are two typical forms of market power manipulation. Owning market power itself is not illegal, while the way how this power is used and the intent of market power owner that contribute to the determination of market manipulation.

1.2 Forms of market manipulation

The complexity of market manipulation could be proved by its various forms. Market manipulation could be categorized into different types according to different classificatory criteria, and the elements that manipulative conducts comprise also vary from one form to another. However, market manipulation is not an open list, and new forms will be invented with the development of financial products or technologies. The following types of market

²⁹ Exchange Act 1934 (SEA 1934), section 9 (a) (1): ***For the purpose of creating a false or misleading appearance of active trading in any security other than a government security, or a false or misleading appearance with respect to the market for any such security...; (3) to induce the purchase or sale of any security other than a government security, any security not so registered, any security-based swap, or any security-based swap agreement with respect to such security by the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any 1 or more persons conducted for the purpose of raising or depressing the price of such security.***

³⁰ Case of *United States v Russo*, 74 F.3d 1383 (2d Cir. 1996), p.10

³¹ Emilios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, pp. 147-148.

manipulation are commonly seen, including wash sales, improper matched orders, painting the tape, advancing the bid, pumping and dumping, marking the close, corner, squeeze, and dissemination of false or misleading information.³² In practice, manipulators prefer mixing more than one method to realize his aim, such as wash sales is used together with spreading false information to create a false impression of a stock's price increase.

Even though types of market manipulation are never exhausted, a good classification will help us to have a better understanding. One of the most popularly classification used by academic researchers in recent years is provided by two American economic professors, Allen and Gale (1992). They classified market manipulation into three types: information-based manipulation, action-based manipulation and trade-based manipulation.³³ Another frequently used classification is stated by the UK law professor, Emiliios Avgouleas. He categorises market manipulation into “information-based manipulation”, “artificial transaction-based manipulation” and “price manipulation”.³⁴ And “price manipulation” has three sub-forms: trade-based manipulation, market-control (market power) manipulation and contract-based manipulation.

There are similarities and differences between these two commonly cited categorization schemes. On the one hand, information-based manipulation is an identical category, stating manipulation by spreading false or misleading information. On the other hand, great differences exist for classifying the rest market manipulation. The central issue is the status of trade-based manipulation. “Trade-based manipulation is the all-encompassing

³² IOSCO also provide other two criteria to classify market manipulation: the objectives of the underlying activity, and the parties involved. See IOSCO, “Investigating and Prosecuting Market Manipulation”, 2000.

³³ Franklin Allen and Douglas Gale, “Stock-price Manipulation”, *The Review of Financial Studies*, Vol. 5, No. 3 (1992), p. 505. This classification is cited in many articles, like “Regulation of Stock Market Manipulation”, 56 *Yale L.J.* 509, P 512-515; Jianping Mei, Guojun Wu and Chunsheng Zhou, “Behavior Based Manipulation: Theory and Prosecution Evidence”, working paper in SSRN library, available at: SSRN: <http://ssrn.com/abstract=457880>; Arkadev Chatterjea, Joseph A. Cherian and Robert A Jarrow, “Market Manipulation and Corporate Finance: A New Perspective”, *Financial Management*, Vol. 22, No. 2 (Summer, 1993), pp. 200-209. Although two more forms of market manipulation, contract-based manipulation and manipulation based on trading combined with disclosure, the general classification given by Fischel and Ross is still the same. Daniel R. Fischel and David J. Ross, pp. 523-526.

³⁴ See Emiliios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, Chapter 4.3 “Market Manipulation, Species, Devices, and Techniques”, pp. 118-154; and Diego Leis, p.32.

category into which all other types of manipulation could fall”,³⁵ therefore, it could comprise contract-based manipulation, in which a trader’s profits result from triggering contractual rights by trading,³⁶ and market power manipulation, trading at the prices controlled by manipulators, could both fall into the form of trade-based manipulation. With regard to “price manipulation”, it is not proper to treat it as a separate form³⁷, as all kinds of manipulation are trying to get illegal profits through influencing the price of an investment instrument.

As a result, combining these two categorization schemes, this paper classifies market manipulations into three categories: information-based manipulation, manipulation based on artificial transactions, and trade-based manipulation.

1.2.1. Information-based manipulation

No matter true or false, complete or incomplete, information is the basis for investors to make their investment judgements in the financial market. Market manipulation explored by spreading false information or disseminating rumours is one of the earliest and commonly used methods, which could be traced back to the late 1600s.³⁸ The information strewed includes but not limited to political and macro-economic situations, affairs about securities or issuers, which might mislead the public to take wrong actions. With the popularization of high technologies and internet, information could be spread in a faster and less-cost manner. This provides manipulators more opportunities to perpetrate

³⁵ Arkadev Chatterjea, Joseph A. Cherian, and Robert A. Jarrow, “Market Manipulation and Corporate Finance: A New Perspective”, Vol. 22, No. 2, pp. 200-209, p. 201.

³⁶ Daniel R. Fischel and David J. Ross, p. 523.

³⁷ Joseph A. Cherian and Robert A Jarrow, p. 202.

³⁸ Manipulation, especially information-based manipulation, was quite common in the Amsterdam market of the late 1600s. Just like David J. Leinweber wrote in his book “Nerds on Wall Street: Math, Machines and Wired Markets”, stocks were “*revolved around speculation about the cargoes of the ships of these companies entering the port. One of the most successful stratagems was the spreading of false rumors in Amsterdam coffeeshouses (Coffy huysen in Dutch) frequented by traders and brokers. Sir de la Vega describes it: “The bulls spread a thousand rumors about the stocks, of which one would be enough to force up the prices.” Manipulators would falsely bid up the prices of stocks through a variety of artifices, including painting the tape and the spreading of overly optimistic news. ”* David J. Leinweber, “Three Hundred Years of Stock Market Manipulations”, *Nerds on Wall Street: Math, Machines and Wired Markets*, p. 256.

information-based manipulation than ever. An analysis of the main categories of manipulation is presented below.

(a) Scalping

Scalping, a typical form of information-based manipulation, means that illegal benefits gained from the purchase of a security by broker-dealers, investment advisers or other capital market professionals before they recommend customers to buy the same security. This practice is usually considered unethical because customers' purchase will increase the security's price, thus enabling the professionals to sell at a profit.³⁹ Market professionals, primarily broker-dealers and investment advisers, are trusted by investors in general thanks to the reputation of their creators,⁴⁰ however this trusts facilitate them to make successful manipulation by providing untrue investment recommendations. In this kind of manipulation, market professionals exploit their trusted positions to enrich themselves at the expense of innocent investors.

The largest number of scalping is perpetrated by investment advisers⁴¹. Investment advisers, with the help of massive media coverage of their activities, acquire significant influence over institutional and retail investors. Especially the latter ones who make their investment decision largely depend on the analyses in the public statements or advisers' reports of "analyst heroes" disseminated by the mass media.⁴²

A significant influenced manipulation case in China, Wang Jianzhong, could perfectly explain how this form of manipulation is perpetrated by investment advisers. Wang

³⁹ Definition is given by the Black's Law Dictionary (9th ed. 2009).

⁴⁰ Jiri Crha, *Insider Dealing and Market Manipulation: A Brief Overview of European Anti-Manipulation Law and its impacts*, Lap Lambert Academic Publishing (September 22, 2010), p. 52.

⁴¹ Generally speaking, there are two types of investment adviser. One is independent adviser, offering recommendation on all financial products for institutional or retail investors and receiving a fee for its advice rather than commission. The other type is adviser employed by financial organisations. This kind of adviser works separately from other employees and only gives advice on the products that marketed by their own organisation or certain several organisations. The latter is dependent on his organisation and faces more serious interest conflict when he gives recommendation about securities involving the same securities with which other part of the institution is dealing.

⁴² Emiliós Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, pp. 119-120.

Jianzhong was a very famous investment adviser and also the executive director in Beijing Shou Fang Investment and Consulting Corporation. He had a good reputation and was named “golden finger” as most of the recommendation that he made on certain security would help investors to get a profit. During the period from January 1st 2007 to May 29th 2008, through his own account and 8 more accounts that he controlled, Wang Jianzhong had bought 38 types of securities, which, soon after, were recommended to the public in his analyst’s reports. After the release of the reports, the prices of related securities increased because of investors’ purchases following his recommendation. Wang Jianzhong sold his securities at a higher price level and succeeded to make a profit of 125,757,599.50 Yuan (about 12,575,760 euro). According to the administrative sanction made by China Securities Regulatory Commission (CSRC), Wang Jianzhong was confiscated 125,757,599.50 Yuan illegal gains and received an administrative-penalty fine of the same amount, which is also the largest fine that has ever been made by CSRC. Besides, Wang Jianzhong also was banned for a life time from practicing in securities services industry.⁴³

(b) Spread of false information and misrepresentation

Compared to scalping, spread of false information and misrepresentation is a more common seen type of manipulation considering that, in this case, perpetrators could be anybody in the capital market, not limited to market professionals. Besides, the abusive information in this case concludes all untrue, inaccurate, incomplete or uncertain information that may have great influence on investors to make decisions. For instance, rumours about the international relationship, political affairs in special regions or health condition of the CEO of the issuer, are all possible to change investors’ original investment plan.

⁴³ CSRC, Administrative Sanction Decision No. 42, 2008; and CSRC Forbidden Access Decision No. 23, 2008.

Spread of false information and misrepresentation, as an old manipulative technology, could be traced back to 300 years ago. At that time, it was quite easy for brokers to run up the stock prices of companies that carried out overseas trades simply through giving hint about the rich cargoes carried on ships soon to enter port in the Amsterdam market.⁴⁴ The situation does not change too much today. Broker-dealers may spread or misrepresent false information about promising future of a company, in order to promote the sale of securities in which they make a market or which have been underwritten by their firm.

Moreover, manipulation by spreading false or misleading information is much easier to perpetrate than ever with the advent of information technology in the modern financial market. This is because, on the one hand, market participants are able to have access to information that used to be hard or expensive to find, and on the other hand, the totally new information can be procured by the public once it appears. For a market manipulator, this means a new and more influencing way for “*transmit and spread rumours, manipulate beliefs, and post incorrect information at little cost, while maintaining the cloak of anonymity*”⁴⁵. Examples of this type of manipulation are uncountable, ranging from the old well-known case of *R v De Berenger*⁴⁶ in 1814, to the famous teenager, Jonathan G. Lebed, internet manipulation case in 2000⁴⁷, and to a recent Wall Street trader manipulation.⁴⁸

⁴⁴ David J. Leinweber, “Three Hundred Years of Stock Market Manipulations”, *Journal of Investing*, Summer 2001, Vol. 10, No. 2: pp. 7–16.

⁴⁵ *Ibide*.

⁴⁶ See *R v De Berenger*, (1814) 3 M&S 67 (KB), 105 Eng Rep 536. This case is about Captain Random de Berenger, conspired with several members of the English aristocracy, illegally profited from sales of two government-based stocks by spreading false news of Napoleon’s death, which had a significant influence in the London Stock Exchange in 1814. Also see Emilios Avgouleas, p. 122.

⁴⁷ Lebed, age 15, on eleven separate occasions between August 23, 1999 and February 4, 2000, engaged in a scheme on the Internet in which he purchased, through brokerage accounts, a large block of a thinly-traded micro-cap stock. After his purchase, Lebed sent numerous false and/or misleading unsolicited e-mail messages, or “spam”, primarily to various Yahoo! Finance message boards, touting the stock he had just purchased. The postings Lebed made to Internet website message boards included baseless price predictions and other false and/or misleading statements. Lebed then sold all of these shares, profiting from the increase in price his messages had caused. More details about the case are available at <http://www.sec.gov/news/press/2000-135.txt>, last visited on 1 March 2015.

⁴⁸ Paul S. Berliner, intentionally spread false rumours about the Blackstone Group's acquisition of Alliance Data Systems (ADS) while selling ADS short. See “SEC Charges Wall Street Short-Seller with Spreading False Rumours”, available at <http://www.sec.gov/news/press/2008/2008-64.htm>, last visited on 1 March 2015.

(c) Manipulation by undisclosed information

Full disclosure of information is critical for the transparency of the financial, which also ensures an equal opportunity for market participant⁴⁹, so it is an obligation provided by the securities law in the main countries. However, there are inevitable situations that a person, such as corporate executives, financial journalists, and officers in the supervisory organisations, who has access to acquire accurate and complete information earlier than the public, abuses his right to get illegal profits.

Nevertheless, information abused in this form of manipulation is different from inside information used in insider dealing, as it does not need to be very precise or relate to issuers or financial instruments. For instance, undisclosed information regarding political affairs, macro-economic policies or governmental budgets could be the devices for manipulators to take advantages to rig specific security's prices angling for illegal profits.

1.2.2 Manipulation based on artificial transactions

Transactions convey information concerning the state of demand and supply of a particular investment instrument in the capital market. Therefore, fictitious trades could also be used for creating a misleading impression, which is not peculiar to the information-based manipulation.⁵⁰ Artificial transactions create the appearances of great demand or supply for certain securities while there is no such demand or supply for them in reality, through which a fraud is made for unsuspecting investors. Artificial transactions-based manipulation is also an old story, and related cases could be found in the form of "trading pools" in the 19th century in the US and the UK.⁵¹ "Wash trades" and "improper matched orders" are two classic forms of fictitious trade-based manipulation while "fictitious orders" is a new coming type in particular with the usage of high technologies.

⁴⁹ Jiri Crha, *Insider dealing and market manipulation: A Brief overview of European Anti-manipulation law and its impacts*, 2010, Lap Lambert Academic Publishing GmbH & Co.KG, p. 45.

⁵⁰ Emiliou Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, pp. 127-128.

⁵¹ *Ibid*, p. 130, note 135,136.

(a) Wash sales

Wash sales (also known as wash trades)⁵² occur when an operator sells and buys the same security at the same time, aiming to change the stock price through artificially influence on trading volume. Wash sale trades are considered as fictitious because there is not real change in the beneficial ownership⁵³ of securities, just like moving the securities from the left hand of the owner to the right one.

Taking the case of Robert Crane for example, Robert Crane was charged by the U.S. Securities and Exchange Commission (SEC) for manipulating the market for two penny stocks. As in June 2010, Crane, by placing his orders through the Internet for trades in his three accounts at two brokerage firms, created a false appearance of an active and liquid market for those two securities, without actually changes of beneficial ownership in the stocks he already owned.⁵⁴ Therefore, wash sale has initially been regulated as securities fraud in the main countries.

(b) Improper matched orders

Another important category of artificial transaction is improper matched orders. Although technique closely to wash sales, improper matched orders involve changes of beneficial ownerships of securities concerned. Improper matched orders occurs when “transactions where both buy and sell orders are entered at or nearly at the same time, with the same price and quantity by different but colluding parties”, unless the transactions could be

⁵² Wash sale is also used to describe another practice that is selling a security at a loss and repurchasing the same or substantially identical stock shortly before or after. It should not be confused with “wash sales” or “wash trades” we used in this article, as the aim of the former is to “make an unrealized loss claimable as a tax deduction by offsetting against other capital gains in the current or future tax years” rather than manipulate the stock price in our case.

⁵³ Cheng Xiao, “Study on the Market Manipulation and its Civil Liability”, the *Science of Legal*, Issue 4(2001), p.91. Beneficial ownership is the actual owner of the securities, different from the ‘title owner’. Although the securities is not under his name, beneficial owner is the one who purchases and control the securities, therefore he enjoys the benefits and undertakes the risks.

⁵⁴ *SEC v. Robert Crane*, Case No. 1:13-cv-00261 CMH (E.D. Va.), available at <http://www.sec.gov/litigation/litreleases/2013/lr22636.htm>, last visit 2 March 2015.

justified by related rules.⁵⁵ The offenders in this type of manipulation must be at least two persons who have a prior knowledge of the plan and reach an agreement about it.

(c) Painting the tape

Painting the tape originated in the past era when “ticker tape” were used to transmit stock prices. It is one of the perennial favourite manipulation methods used to trick unwary investors, which could go back as far as three hundred years ago in the Amsterdam stock market.⁵⁶ Painting the tape is the practice of making transactions among manipulators for the explicit purpose of influencing the price of a security, so as to give the impression of high trading volume or certain price movement in that security, which can attract unsuspecting investors to buy.

A typical example of painting the tape is that brokers, using their customers’ accounts, make numerous buy and sell orders for a security to push its price up. Once investors’ purchases push up the security’s price as brokers’ desire, they will offset their holdings, succeeding to make a profit. Painting the tape is quite similar to improper matched orders, so some scholar claims that it is unnecessary to distinct from these two forms of market manipulation.⁵⁷ Nevertheless, differences between them could not be ignored. In case of painting the tape, there is no prior agreement between brokers and investors, and brokers get the benefits while investors face losses.

(d) Fictitious orders (Placing orders with no intention of executing them⁵⁸)

Fictitious orders manipulation is operated in a way that operators frequently makes orders with prices higher or lower than the previous bids and then withdraws them from the market before execution. The orders are fictitious because manipulators do not intent to

⁵⁵ The first set of CESR guidance and information on the common operation of the Market Abuse Directive, CESR/04-505B.

⁵⁶ David J. Leinweber and Ananth N. Madhavan, “Three Hundred Years of Stock Market Manipulations”, p. 2.

⁵⁷ Mathias Siems and Mattijs Nelemans, “The Reform of the EU Market Abuse Law: Revolution or Evolution”, the *Maastricht Journal of European and Comparative Law*, vol 19 (2012), pp 195-205.

⁵⁸This term is used in the first set of CESR guidance and information on the common operation of the Market Abuse Directive, CESR/04-505B, p. 11.

execute them but to create a misleading appearance of the high trading volume or price movement of the financial instrument concerned. “A variant on this type of market manipulation is to place a small order to move the bid/offer price of the financial instrument and being prepared for the order to be executed if it cannot be withdrawn in time.”⁵⁹

Fictitious orders manipulation is commonly used since the rise of electronic communication networks, which allow traders to place orders anonymously and to cancel them immediately with no consequence. Cases with regard to fictitious orders have increased substantially and such practices become regularly in the capital market in recent years. As a result, this form of manipulation has drawn more attention from the regulators since the beginning of the twentieth century.⁶⁰

1.2.3 Trade-based Manipulation

Trade-based manipulation is hard to eradicate because its occurrence is made by manipulators’ actual buying and selling, without taking any publicly observable actions to alter the value of the firm or releasing false information to change the price.⁶¹ It could be simply understood as actual trades in the financial market with “bad intent”.

Regulation of trade-based manipulation is not treated as a matter of course compared with the former two categories of market manipulation. Some experts argued that trade-base manipulation is self-detering taking account of large number of capital or stock requirements for a successful manipulation. Besides, manipulation by actual transitions does not have a clear border with legitimate trades, the prohibition of which will raise significant social costs while acquiring few benefits.⁶² However, this theory is proved to be untrue by both theory and practices. On the one side, the big number of illegal profit

⁵⁹ The first set of CESR guidance and information on the common operation of the Market Abuse Directive, CESR/04-505B, p. 11.

⁶⁰ Gretchen Morgenson, “Chasing Ghosts at Nasdaq”, New York Times (1999). And Wang Dongmin, Wang Maobin and Zhao Jing, “New Developments in Order-based Manipulation and Its Regulation”, the *Securities Market Report*, January 2011, pp. 16-23.

⁶¹ Franklin Allen and Douglas Gale, p. 505.

⁶² Daniel R. Fischel and David J. Ross, pp. 512-523.

will always urge some person to take the risk; on the other hand, the capital needed to manipulate a low liquid security is not achievable, in particular when manipulators are more than one or professional organizations.⁶³

Given its difficulty of detection and various derivative forms, trade-based manipulation is the main content provided by market manipulation regulation, like US SEA 1934 (section 9), Market Abuse Directive (Article 1 (2) (a)). Forms of manipulation based on actual transactions are never exhausted, and the following cases are just the main types that are usually perceived in practice.

(a) Marking the close

“Marking the close”, also known as “trading at the end of the day”, means that buying or selling a financial instrument just before the close of trading day in an effort to alter closing price of that instrument. Closing price is one of the most important figures since that it usually is the standard for judging the market situation of an instrument on that day and also is the basis for the opening price on the next day. In many cases, market participants use closing price as the main basis to predict instruments’ price tendency and make investment decisions. For manipulators, “marking the close” is a favourite method, because no more trades can be made after that, which means less risky and lower cost to secure the instrument’s price as they desired. Therefore, intent is the key elements to differentiate a manipulative conduct from the legal transitions made at the end of the trading day.

(b) Advancing the bids

“Advancing the bids” occurs when manipulators successively increase the bid for a financial instrument to increase its price. As soon as he succeeds to make the price at a planned level, a manipulator will offset his possessions of that instrument to retail

⁶³ Steve Thel, “\$850,000 in six minutes—the mechanics of securities manipulation”, the *Cornell Law Review*, January 1994, 79 *Cornell L. Rev.* 219, pp. 219-298; and Franklin Allen and Douglas Gale, p. 506.

investors (in normal case) to get a profit. Usually, “advancing the bids” is quite risky and expensive to exercise considering the large number of money needed and the possibility of failing to attract investors. However, this kind of manipulative practice still has chance to succeed when combined with spreading false information, particularly for large market traders or market intermediaries, who have a big money or influence advantage.

(c) Abusive short selling

Short selling (or short sales, short) has a long and arguable history, the regulation of which is still going through seriously debate in recent years. A short seller is the one who sells a security or other financial instrument, which he does not own or he owns but has not delivered. He delivers to the buyer shares that are borrowed from a shareholder, often broker-dealers or institutional investors. Short selling per se is neutral, just the reaction of traders who believe that the price of a security will fall⁶⁴. If used appropriately, short selling could help the capital market to promote efficiency by eliminating overpricing.⁶⁵

However, short selling is also believed to depresses the price of a security through successive sales or one big enough selling activity, which creates a misleading impression that the security is overvalued. If such sales are made deliberately, they should be considered as manipulative. In contrast to “advancing the bids”, manipulators here benefit from selling borrowed securities at higher price and then buying them back at lower price to deliver. Generally speaking, short selling is a very popular situation that companied by manipulative conducts, in particular in the case of naked short selling.

Naked short selling means that, a seller sells security short without borrowing the necessary security or making a good faith arrangement to borrow the security, or without reasonable belief that the seller can borrow the security by the settlement day”, thus

⁶⁴ Daniel R. Fischel and David J. Ross, p. 521.

⁶⁵ Finnerty, John D., “Short Selling, Death Spiral Convertibles, and the Profitability of Stock Manipulation” (March 2005), available at SSRN: <http://ssrn.com/abstract=687282>, last visited on 1 March 2015.

potentially results in a fail to deliver security to the buyer.⁶⁶ Consequently, naked short selling may lead to a big damage to the capital market, since the failure of deliver securities, not only distorts the securities clear system, but also generates artificial trading prices. Accordingly, naked short selling is prohibited even in the US which has very lenient law towards short selling.

However, except naked short shelling, the tolerant attitude towards short selling of regulators in the EU is forced to change in the wake of the 2008 global financial crisis and debt crisis. Short selling is going to face more strict regulation with regard to its close relationship with market manipulation.

(d) Cornering the market

Cornering the market is a classic type of market manipulation abusing market power (or market position), observed more frequently in futures markets. Cornerers create a dominant position in controlling either the supply or demand-side of both the derivative and underlying asset of selected investment instrument. This dominant position forces buyer or sellers, usually those who “have to deliver, take delivery or defer delivery of the instrument/product in order to satisfy their obligations”⁶⁷, to accept the distorted price provided by manipulators. Cornering the market has a long history, and it is never short of typical cases. For example, the 1869 Black Friday was caused by cornering the gold market on the New York Gold Exchange; the 1970s Silver Thursday was made by the Hunt brothers cornering the world silver markets; and between 2007 and 2010, cornering the market in shares of Volkswagen by Porsche, although unsuccessful, still made a big damage.⁶⁸

(e) Abusive squeeze

⁶⁶ Christopher L. Culp, J.B. Heaton, “The Economics of Naked Short Selling”, spring 2008, p.p. 46-47, available at <http://www.cato.org/sites/cato.org/files/serials/files/regulation/2008/2/v31n1-6.pdf>, last visited on 28/05/2013.

⁶⁷ The first set of CESR guidance and information on the common operation of the Market Abuse Directive, CESR/04-505B, p. 12.

⁶⁸ More cases about cornering the market are available at http://en.wikipedia.org/wiki/Cornering_the_market.

Abusive squeeze is the other typical form of market manipulation exploiting market position. According to rules made by IOSCO, abusive squeeze is defined as “taking advantage of a shortage in an asset by controlling the demand-side and exploiting market congestion during such shortages in such a way as to create artificial prices”. Sometimes people use “abusive squeeze” and “cornering the market” interchangeably, maybe because large traders often use former method accompanied by the latter. But these two manipulative behaviours have different aspects. An obvious distinction is that manipulators do not usually possess the underlying commodity or financial instruments concerned in abusive market squeeze.

1.3 Rationales for the regulation of market manipulation

1.3.1 General introduction

By and large, the prohibition of market manipulation has received much fewer objections than insider dealing, despite the hard questions posed by defining market manipulation. The opinion that market manipulation does not need specific regulation is only showed in the article, “*Should the Law Prohibit ‘Manipulation’ in Financial Markets?*” published by Daniel R. Fischel and David J. Ross in 1991. Fischel and Ross claimed that legal prohibition of market manipulation is not necessary, since that information-based manipulations and artificial transactions-based manipulations are securities frauds in nature, which have already been regulated by legislations; while trade-based manipulation is self-deterrence because of its difficulty to profit, and also because their prohibition results in significant social costs and undermines traders’ freedom.⁶⁹

However, more opposite opinions are expressed by both legal scholars and economists after this article’s publish. They argued that profitable market manipulation is possible, so it cannot be self-deterrence as a matter of fact. A series of theoretical and empirical studies also prove that market manipulators can move investment instruments’ prices by trading

⁶⁹ Daniel R. Fischel and David J. Ross, pp. 510-513, 522-523, 547-549.

and can make illegal profits from doing so.⁷⁰ Therefore, regulation of market manipulation is necessary way to ensure the well function of the financial market and to enhance the confidence of investors.

The widely accepted theories, that explain the reason why market manipulation should be regulated, include Efficient Capital Market Hypothesis (ECMH), social costs and moral considerations.

1.3.2 Efficient Capital Market Hypothesis and market manipulation

Efficient Capital Market Hypothesis (ECMH) is one of the fundamental theories for modern capital market, which could be simply stated as “security prices fully reflect all available information”, under a precondition that information and trading costs and the costs of getting prices to reflect information are always zero; or more sensible that prices reflect information to the point where the profits made by acting on information are less than the marginal costs.⁷¹ Started with studying the processes determining security prices in 1950s, ECMH has gradually been widely accepted through a line of theoretical inquiry and empirical research,⁷² even though it faces more criticism from the behaviour economists after the 1990s stock bubbles⁷³. Accordingly, a capital market is efficient when investment instruments’ prices fully reflect all the relevant information available to

⁷⁰ Franklin Allen and Douglas Gale, “Stock-price Manipulation”, *The Review of Financial Studies*, Vol. 5, No. 3 (1992); Bruno Gerard & Vikram Nanda, “Trading and Manipulation around Seasoned Equity Offerings”, 48 J. FIN. 213 (1993); Robert A. Jarrow, “Market Manipulation, Bubbles, Corners, and Short Squeezes”, VOL. 27, NO 3, *Journal of Financial and Quantitative analysis*, September 1992; Steve Thel, “\$850,000 in six minutes—the mechanics of securities manipulation”, *Cornell Law Review*, January 1994, 79 Cornell L. Rev. 219, p.p. 219-298.

⁷¹ Eugene F. Fama, “Efficient Capital Markets: II”, the *Journal of Finance*, Vol. 46, No. 5 (Dec., 1991), pp. 1575-1617, p.1575.

⁷² In the seminal article concerning ECMH, Professor Fama developed the former efficient market theory into ECMH. He divided work on market efficiency into three categories: (1) weak-form tests (How well do past returns predict future returns?), (2) semi-strong-form tests (How quickly do security prices reflect public information announcements?), and (3) strong-form tests (Do any investors have private information that is not fully reflected in market prices?). He makes a conclusion that, general speaking, the capital market is efficient and few empirical cases exist.

Also see Eugene F. Fama, pp. 1575-1617; and Christopher Paul Saari, “The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry”, *Stanford Law Review*, May 1977, 29 Stan. L. Rev. 1031, pp.1031-1076, p.1034.

⁷³ Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance*, Oxford University Press, November 2003, p.23.

investors. That is to say the present prices of investment instruments represent all current relevant market information, and any future changes in price are unpredictable. In a similar way, prices cannot correctly reflect these fundamentals if false information is added.

Market manipulations, however, destroy the capital market efficiency by adversely influencing its price formation mechanism. Manipulators feed the market with false or misleading information which distorts the whole market information quality, either through spreading rumours or by creating an artificial impression of the supply and demand state of an investment instrument. Under this situation, inefficient price of that instrument is formed, transmitting inaccurate assumptions regarding future profitability to investors, and then channelling resources to not so efficient usage. Given the fact that the primary role of capital market is allocation of fund, such misallocation has a detrimental effect on the whole market, which could be proved by those tragic consequences caused by the 1869 Black Friday, the Guinness share-trading fraud in the 1980s, the eruption of the Enron, WorldCom, Parmalat and other corporate frauds in the 20th century.

1.3.3 Costs and benefits of market manipulation regulation

“Regulation improves outcome when enforcing contracts is very costly (Posner, 1998) or when limited liability restricts the ability to punish deviants (Shavell, 1984).”⁷⁴ Regulation also play an important role when contracts are incomplete or has difficulty in renegotiation, which is a quite common situation in the capital market, as most of the time one parties of the contracts are retail investors who are dispersed and lack of professional knowledge and money. These rationales are totally applicable in the case of market manipulation regulation. Hence, the prohibition of market manipulation can enhance the whole market welfare and secure its well function.

⁷⁴ Zingales, Luigi, “The Costs and Benefits of Financial Market Regulation”, April 2004, ECGI-Law Working Paper No. 21/2004, pp. 2-3.

However, the regulation of market manipulation is not accepted by all the people. A typical opposite opinion is brought up by Professors Fischel and Ross. They argued that the costs of legal prohibition of market manipulation are more than its benefits. They claimed that, on the one hand, the enforcement costs are higher for manipulation than for other intentional rules, as manipulative acts are indistinguishable from normal trading on appearance and it is too difficult to judge only through manipulators' mental state;

On the other hand, sanctions are very severe for market manipulation, even including criminal liability, so the error costs will be too high considering the fact that non-manipulative trading might quite easily be confused with manipulative ones. Further, the punishment of manipulation will also discourage those social desirable activities, like stabilization, which is a kind of manipulation in nature.⁷⁵

Nevertheless, it should be reminded that Fischel and Ross try to prove that costs of these rules outweigh benefits made, rather than argue that markets should not have rules against market manipulation. It's true that the regulation of market manipulation is not going to be costless, but the potential costs are limited compared with substantial benefits.

Firstly, regulation is a better choice when private responses of market manipulation are not enough to deter it. It is difficult for private parties to discover manipulation and even they could, few would like to bring suits since there is an important fixed cost for doing so.⁷⁶ Market intermediaries have more abilities than retail investors to deter manipulation, unfortunately this is not the case because they might just be manipulators or profit by taking advantage of market manipulation.

Secondly, if the prohibition rules only target behaviors with "bad intent", they can realize the aim of preventing objectionable practices without discouraging most appropriate conducts.⁷⁷

⁷⁵ Daniel R. Fischel and David J. Ross, pp. 522-523.

⁷⁶ Zingales and Luigi, p. 22.

⁷⁷ Steve Thel, pp. 287-288.

And finally, benefits of market manipulation regulation increase as the quick integration of international capital markets. Manipulation perpetrated through internet or cross-border is more easily and less risky, however, such manipulative activities are not self-deterrence and are impossible to be prohibited efficiently by single state regulators. Consequently, international supervisory and enforcement networks should be established in order to support information exchange and joint investigation between countries.⁷⁸

1.3.4 Moral consideration

Morality consideration is another reason why market manipulation should be regulated. Manipulative schemes always involve deceptive conducts, such as spreading rumors, disseminating misleading messages or creating artificial transactions. These acts in nature are a kind of fraud, which is against the common value of human beings. This character makes the prohibition of market manipulation less controversial at least than insider trading. So in common law market manipulation was regulated as securities fraud at the very beginning. And this is still the same way of dealing with manipulation in some occasions, especially for market information-based manipulation and artificial transactions-based manipulation. For example, Section 9 of the SEA prohibitions (*Prohibition against Manipulation of Security Prices*)⁷⁹ are supplemented by section 10 (Manipulative and deceptive devices)⁸⁰ and section 15(c).⁸¹

Conclusion of Chapter 1

Market manipulation is an illegal practice which enable perpetrators profit from raising or lowering the prices of an investment instrument in capital market, which are created by spreading false information, by making fictitious trading or by actual trading but with bad

⁷⁸ Emilius Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, p. 215.

⁷⁹ 15 U.S.C.A. § 78i.

⁸⁰ 15 U.S.C.A. § 78j.

⁸¹ Thomas Lee Hazen, “Manipulation and Fraud—Civil liability; Implied private remedies; SEC rule 10B-5; Fraud connection with the purchase or sale of securities; Improper trading on non-public material information”, in the *Treatise on the Law of Securities Regulation*, Database updated January 2013, 3 Law Sec. Reg. § 12.1, p. 2.

intent. It makes damages to the financial market through affecting the price formation mechanism and destroys investors' confidences.

Market manipulation is a complex offence. It has numerous forms and new forms are created with new financial products and technologies. Manipulations are classified into three categories in this thesis. Information-based manipulation and artificial transaction-based manipulation are two traditional categories, which are better regulated in the main jurisdictions. Yet they have new developments with the advent of new communication technologies and the integration of international capital market. And the last one, trading-based manipulation, is more complicated than the former two. Given its vague border with legal transitions, trade-based manipulation is difficult detect and determine, therefore becomes the major issue for legislators and regulators in recent years.

Compared with insider dealing, the prohibition of market manipulation raises fewer arguments. The reason of its regulation could be explained by the ECMH theory, cost and benefit analysis and moral consideration. Market manipulation regulation has the advantages of reducing adverse influence on price formation mechanism, getting higher benefits received than social costs, and fighting against frauds (immorality).

Chapter 2 Market manipulation regime under the Market Abuse Directive

Market manipulation, together with insider dealing, is the main content of market abuse regime. Its regulation has become predominantly European-based in EU Member States, with directives being the predominant source of the law.⁸² Market Abuse Directive and its implementing acts established the basic legal framework for the regulation of market manipulation, contributing to the prohibition of misconducts in the financial markets.

2.1 History of EU market manipulation regulation

The first EU-level legislation concerning market abuse regime is Directive 89/592/EEC⁸³ (popular known as the Insider Dealing Directive), adopted in 1989. Unfortunately, only insider dealing was provided in in this Directive, while nothing with regard to market manipulation was mentioned. However, a sea change happened in financial market soon after. With the development of new technologies and financial products, cross-border transitions are becoming more and more common. Regulatory fragments became a serious issue in the EU financial market, which provides more opportunities for market manipulators.⁸⁴ The increasing number of market manipulation cases during the 1990s stock market bubble revealed that the old market abuse regulation could not keep pace with new issues turning up.⁸⁵ As a result, a new directive, Directive 2003/6/EC (also known as Market Abuse Directive)⁸⁶, was adopted and market manipulation was firstly regulated in the EU.

EU legal framework for market manipulation is established by the 2003 Market Abuse Directive, which is also the first directive created following the Lamfalussy four-level

⁸² Mathias Siems and Mattijs Nelemans, "The Reform of the EU Market Abuse Law: Revolution or Evolution", the *Maastricht Journal of European and Comparative Law*, vol 19 (2012), pp. 195-205.

⁸³ Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing

⁸⁴ Sheng Xuejun, *Study on the EU Securities Law*, Law Press. China, 2005, pp. 167-170.

⁸⁵ Ibid

⁸⁶ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)

regulatory approach (hereinafter referred to as Lamfalussy process).⁸⁷ Shortly after the issuing of Market Abuse Directive, four level 2 implementing legislative acts⁸⁸, which provided detailed technical rules about manipulation, were adopted subsequently. And three sets of level 3 guidance on the common operation of the Market Abuse Directive were issued by the Committee of European Securities Regulators (CESR, now the European Securities and Market Authority (ESMA)). The CESR guidance does not have binding effects, and it is only limited to the competent authorities. However, this guidance contributes to ensure uniformed implementation in Member States by providing clear explanations or recommendations during enforcement. These measures at large offer a general framework of market manipulation, which has played an important role in protecting the smooth functioning of the financial market and in enhancing the public confidences in the EU.

Although the market manipulation regime established by the Market Abuse Directive is considered as a success in general, some regulatory deficiencies, such as lack of clarity and legal certainty, disproportionate administrative burdens on issuers, have become serious

⁸⁷The Lamfalussy Approach was suggested in the Final Report on the Regulation of European Securities Markets proposed by the Committee of Wise Men in 2001. It contributes to solve the slow and complex problem of law-making process in the financial area. The new methodology is comprised of four levels of legislation. At the first level, framework principles by way of directives or regulations are adopted by ordinary EU legislative procedures, provided in Article 294 TFEU. At the second level, the European Commission, together with the European Securities Committee and the European Securities and Market Authority, adopts implementing measures in directives or regulations. And the measures adopted under this level are considered as delegated or implementing acts. At the third level, national securities authorities cooperate together and the European Securities and Market Authority provides recommendations, guidelines and common standards to ensure consistent application and transposition of EU rules. And at the fourth level the Commission checks Member State's compliance of with EU legislation and will take legal action against the Member States suspected of breach of EU law.

http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf, last visit January 29, 2013.

⁸⁸ These four acts are *Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation* (Directive 2003/125/EC), *Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest* (Directive 2003/125/EC), *Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments* (Regulation 2273/2003), *Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions* (Directive 2004/72/EC).

issues because of the increasing competition among new markets, trading platforms and over-the-counter (OTC) and the use of technologies.⁸⁹ In particular after the breaking out of the global financial crisis, a series of broad-influence cases⁹⁰ remind us that more improvements should be made to the regulation of market manipulation.

In 2010, the Commission launched a public consultation on the review of the Market Abuse Directive. Its objective was to consult financial market participants, governments, competent authorities and other stakeholders on the modifications to the Market Abuse Directive that the Commission is considering for its forthcoming legislative proposal. Later in June 2011, the Commission adopted a proposal for a Regulation on insider dealing and market manipulation (market abuse), and another for a Directive on criminal sanctions for insider dealing and market manipulation.⁹¹ And these two proposals were finally adopted by the European Parliament and the Council on 12 June 2014.

The new rules, Regulation No 596/2014 on market abuse and Directive 2014/57/EU on criminal sanctions for market abuse, update and strengthen the existing framework to ensure market integrity and investor protection provided by the existing Market Abuse Directive (2003/6/EC) which will be repealed in 2016.⁹²

2.2 Scope and exceptions of the prohibition on market manipulation

Market Abuse Directive is considered as the first legislation that prohibits market manipulation by name. Its prohibition is straightforward: “*Member States shall prohibit*

⁸⁹ Commission, Commission Staff Working Paper: executive summary of the impact assessment, SEC (2011) 1218 final.

⁹⁰ The Libor and Euribor manipulation scandal, details available at http://en.wikipedia.org/wiki/Libor_scandal; Morgan Stanley manipulation concerning false reporting of futures trades, details available at <http://www.ft.com/cms/s/0/aa6ea7ae-f886-11e2-92f0-00144feabdc0.html>; CFTC manipulation about crude oil futures price, details available at <http://online.wsj.com/article/SB10001424052702303796404579097200823946312.html>, and etc.

⁹¹ Proposal for a Regulation of the European Parliament and the Council on insider dealing and market manipulation (market abuse), reference 2011/0295 (COD); Proposal for a Directive of the European Parliament and the Council for criminal sanctions on insider dealing and market manipulation, reference 2011/0297 (COD).

⁹² European Commission, Daily News on 12 June 2014, EXME 14/ 12.06.

any person from engaging in market manipulation.”⁹³ Since market manipulation and insider dealing are under the same framework, this arrangement can ensure a better regulation for the wrongdoings that mix using these two abusive methods.

2.2.1 A broad scope of market manipulation prohibition

Market manipulation rules provided in the Market Abuse Directive has a very broad scope. It applies to any financial instrument admitted to trading on a regulated market in at least one Member State, or for which a request for admission to trading on such a market has been made, irrespective of whether or not the transaction itself actually takes place on that market.⁹⁴ This means that the determination of manipulative behaviour hinges on two key definitions: financial instrument and regulated markets.

Financial instrument is defined in Article 1(3) of Market Abuse Directive, covering equity, debt, commodities, derivatives thereof and other kinds of securities. It is not exaggerated to conclude that all the financial instruments allowed to trade on a regulated market are within the meaning of Market Abuse Directive.⁹⁵

The other core definition is “regulated markets”, the transitions on which fall into the prohibition of market manipulation. Regulated market is provided in Article 4(1)(14) of MiFID⁹⁶, which repealed Article 1(13) of Directive 93/22/EEC. According to the Court of Justice of the European Union (CJEU), two conditions are required for classifying a market in financial instruments as a “regulated market”. Firstly, it must be authorised as a

⁹³ Market Abuse Directive, Article 5.

⁹⁴ Market Abuse Directive, Article 9, the first indent. A further situation is applied only for insider dealing prohibition in the second indent of that article.

⁹⁵ Jesper Lau Hansen, ‘MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive’ (2004), *European Business Law Review*, Issue 2, pp. 183–221.

⁹⁶ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (hereafter mentioned as MiFID), Article 4(1)(14): ‘*Regulated market*’ means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III.

regulated market by a Member State. And secondly, its operation should be in accordance with the requirements set out in Title III of MiFID, which is an essential condition for obtaining and maintaining that authorisation. The situation where an operator of a regulated market also operates another trading system is not the reason for that trading system to become a “regulated market”. Moreover, the inclusion of a market on the list of regulated markets mentioned in Article 47 of MiFID is also not a constitute element for the classification of that market as a “regulated market”.⁹⁷

2.2.2 Exceptions for the prohibition of market manipulation

Given the wide scope of market manipulation prohibition, a blanket exception for market manipulation prohibition is provided by the directive in order to avoid legal activities to be punished. In general, exceptions include two categories. The first one is concerning special transitions, which are “*carried out in pursuit of monetary, exchange-rate or public debt-management policy by a Member State, by the European System of Central Banks, by a national central bank or by any other officially designated body, or by any person acting on their behalf. Member States may extend his exception to their federated States or similar local authorities in respect of the management of their public debt*”. The second category includes safe harbours (buy-back programmes and stabilization⁹⁸) and Accepted Market Practices, which will be analysed in detail.⁹⁹

2.3 Definition and identification of market manipulation

Only the prohibition itself is not really useful because it depends on how market manipulation is defined. As mentioned in Chapter 1, market manipulation has too many forms and shows different appearances in different manipulative practices, so “formal, detailed definitions (of market manipulation) are unlikely to capture the full range of manipulative activity and are likely to become outdated rapidly.”¹⁰⁰ Inflexible definition

⁹⁷ CJEU Case C-248/11, paragraph 43, 46, 48-54.

⁹⁸ Buy-back programmes and stabilization are further provided in Commission Regulation 2273/2003.

⁹⁹ Market Abuse Directive, Article 7 and 8; and Regulation 2273/2003.

¹⁰⁰ Niamh Moloney, *EC Securities Regulation*, Oxford Press, 2008, 2nd edition, p. 981.

might also encourage potential abusers to develop practices which fall outside the scope of prohibition.

Therefore, EU defines market manipulation in a complicated way: first, a general clause concerning three categories of market manipulation is provided in level 1 Market Abuse Directive; secondly, further indicators are set out in level 2 Commission Directive 2003/124/EC (article 4 and 5) and Commission Directive 2004/72/EC (article 2); and lastly typical examples of various of practices which might constitute market manipulation are given in level 3 CESR guidance.

Besides, Market Abuse Directive chooses the effect-based approach to define market manipulation, according to which intention is not a necessary condition. This greatly reduces the difficulty of determining a manipulative activity by the judges and regulators and, as a result, increases the enforcement efficiency.

2.3.1 Market manipulation by transactions or orders to trade

Market manipulation by transactions or orders to trade (no matter real or fictitious) is the first part of EU's market manipulation definition. It means transactions or orders which: (a) give, or are likely to give, false or misleading signals with regard to the supply of, demand for or price of financial instruments, or secure the price of one or several financial instruments at an abnormal or artificial level,¹⁰¹ or (b) employ fictitious devices or any other form of deception or contrivance¹⁰².

Two features are worth mentioning in this core definition. One is that since the "effect-based approach" is adopted, mental element of manipulator is not a necessary element, which makes this form of manipulation much easier to prove. But problems exist in further clearing the concept of "abnormal or artificial price level" just like in other foreign jurisdictions.

¹⁰¹ Market Abuse Directive, Article 1(2)(a).

¹⁰² Market Abuse Directive, Article 1(2)(b)

The other feature is that this definition covers a very broad scope of manipulative activities, which can be classified into three sub-parts: false or misleading transactions (the first indent of Article 1(2)(a) of Market Abuse Directive), price positioning (the second indent of Article 1(2)(a)) and transactions involving fictitious devices or deceptions (Article 1(2)(b))¹⁰³. In particular, the flexible Article 1(2)(b) is designed to be a catch-all clause, ensuing that new devices of manipulation in the financial market could all be covered. In order to protect social desirable behaviors, transitions with legitimate reasons could be justified by safe harbors (buy-back programs and stabilization) and accepted market practices.¹⁰⁴

2.3.2 Market manipulation by dissemination of false or misleading information

Market manipulation by dissemination of false or misleading information is stipulated in Article 1(2)(c) of the Market Abuse Directive. The person who knew, or ought to have known, that the information was false or misleading, is prohibited from disseminating the information through the media and any other means, especially internet. And the information concerned, including the dissemination of rumors and false or misleading news, shall give, or be likely to give false or misleading signals regarding financial instruments.¹⁰⁵ It is designed to include manipulative practices involving dissemination of false and misleading information without necessarily undertaking any accompanying transaction.¹⁰⁶

Information-based manipulation also explores the “intent-based approach”. The court or a regulator does not need to prove that a perpetrator intent to induce market participants to trade in the instruments affected by the misleading or false information spread. Only the

¹⁰³ These three terms are used in the first set of CESR guidance.

¹⁰⁴ Accepted market practices are only limited to the first two kinds of practices provided in Article 1(2)(a) of Market Abuse Directive.

¹⁰⁵ Market Abuse Directive, Article 1(2)(c).

¹⁰⁶ The first set of CESR guidance.

action of spreading such information is enough. However, manipulator shall know, or ought to have known, the information he disseminated is false or misleading.¹⁰⁷

None the less, problems exist in this issue. Disseminating false or misleading information is not always explicitly distinct from exercising the right of free speech, in particular under the situation where right and wrong is not always clear. As a result, harsh punishment for misinformation might impede the exercise of such.¹⁰⁸ As a result, special reference is made to journalists considering their professional features. Compared to other persons, journalists who act in their professional capacity are considered as manipulators only when they derive, directly or indirectly, an advantage or profits from disseminating rumors and false or misleading news, otherwise these misbehaviors are judged by rules governing their professions.

Moreover, the risk of abuse of market manipulation prohibition is balanced by the fundamental rights and principles relating to freedom of the press and freedom of expression in the media recognized in Article 11 of the Charter of Fundamental Rights of the European Union and Article 10 of the European Convention on Human Rights.¹⁰⁹

2.2.3 Indicators of market manipulation

Market manipulation is extremely difficult to determine in practice, mainly because of its non-ending emergence of new devices and a diverse mixture of manipulative techniques. The definition provided in the Article 1(2) of the Market Abuse Directive aims to include all new forms of manipulative practices, but it is hard for application considering its generality. Therefore, except for three instances given in second section of Article 1(2), both Directive 2003/124/EC and the first set of CESR guidance¹¹⁰ provide non-exhaustive lists of possible signals or examples, which should not necessarily be deemed in

¹⁰⁷ Sheng Xuejun, *Study on the EU Securities Law*, pp. 215-219.

¹⁰⁸ Jesper Lau Hansen, "MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive" (2004), *European Business Law Review*, Issue 2, pp. 183-221.

¹⁰⁹ Market Abuse Directive, recital 44

¹¹⁰ The first set of CESR guidance and information on the common operation of the Market Abuse Directive, CESR/04-505B, Part IV.

themselves to constitute market manipulation, shall be taken into account when detecting transactions or orders in question. These indications would facilitate market participants and competent authorities with the identification of market manipulation.

2.3.1.1 Dissemination of false or misleading information

Manipulation by dissemination of false or misleading information is the least complicated one among the four variants that are provided in Article 1(2) of Market Abuse Directive, as it covers straight-forward situations like securities fraud.¹¹¹ So only the first set of CESR guidance mentions a few examples in its paragraph 4.14.¹¹²

A false or misleading signal as to financial instrument could be created positive actions or by negative inactions, through the venue of media or other means. For example, an issuer fails to disclose inside information, which is not except from disclosure, or a manipulator deliberately makes the movement of physical commodity stocks to create a misleading impression concerning the supply or demand for a commodity or the deliverable into a commodity futures contract.¹¹³ It would not be wrong to conclude that, besides exclusion of “scalping”, the type of manipulation provided in Article 1(2)(c) is information-based manipulation, that is discussed in Chapter 1.

2.3.1.2 False or misleading transactions

The second variant provided in the first indent of Article 1(2)(a) is manipulation by false or misleading transactions, which could also be named as artificial transaction-based manipulation. Non-exhausted situations are listed by the directives and guidance where fictitious transactions or orders would happen. For instance, buying or selling a large

¹¹¹ Alexandra Ioana Odagescu, “Analyses of the EU Market Abuse Directive: A Need to Review”, BULETINUL Vol. LX No.3/2008, pp.63-72.

¹¹² However, some scholar consider the second paragraph, the third indent, of Article 1(2) of Market Abuse Directive as an indicator of manipulation by dissemination of false or misleading information. See Jesper Lau Hansen, “MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive” (2004), *European Business Law Review*, Issue 2, pp. 183–221.

¹¹³ The first set of CESR guidance, paragraph 4.14.

volume of a financial instrument with an explicit aim to mislead unsuspecting investors;¹¹⁴ transactions undertaken lead to no change in beneficial ownership;¹¹⁵ and entering significant orders in the central order book of the trading system right before the price determination phase of the auction and then cancelling them just before the order book is frozen.¹¹⁶ Typical examples given by CESR include wash trades, painting the tape, improper matched orders and fictitious orders (placing orders with no intention of executing them).¹¹⁷

2.3.1.3 Price positioning

Price positioning manipulation¹¹⁸ is conducted through real transactions by a person or persons acting in collaboration with the effect of securing the price of financial instrument. It belongs to trade-based manipulation that is discussed in Chapter 1. Market manipulation exploring this device is the most complex variant, because creating an artificial price level requires advantages in capital or stock possession, or the use of futures, options or derivatives. Therefore, more indicators are provided.

In the first section Article 1(2) of Market Abuse Directive, second indent, price positioning could be conducted *“by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument which has the effect of fixing, directly or indirectly, purchase or sale prices or creating other unfair trading conditions”*. Article 4 of Commission Directive and paragraph 5.10 of the first set of CESR guidance indicate more signals that might constitute market manipulation, such as considerable transactions undertaken within a short time span leading to a price change which is subsequently reversed; the change of price caused by orders to trade given or transactions undertaken presenting a significant proportion of the daily volume or

¹¹⁴ Market Abuse Directive, Article 1(2), the second section, indent 2.

¹¹⁵ Commission Directive 2003/124/EC, Article 4(c)

¹¹⁶ The first set of CESR guidance, paragraph 5.10(j).

¹¹⁷ The first set of CESR guidance, paragraph 4.11.

¹¹⁸ Price positioning manipulation is also known as “abuse of a dominant position” by some scholars. Jesper Lau Hansen, “MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive” (2004), *European Business Law Review*, Issue 2, pp. 183–221.

transactions in the relevant financial instrument, or by persons with a significant buying or selling position. Typical examples of price positioning manipulation include marking the close, colluding in the aftermarket of an IPO, abusive squeeze, creation of a floor in the price pattern, excessive bid-ask spreads, and trading on one market to improperly position the price of a financial instrument on a related market.¹¹⁹

2.3.1.4 Transactions involving fictitious devices or deception.

The fourth variant of manipulation, provided in Article 1(2)(b) of Market Abuse Directive, is perpetrated by transactions involving fictitious devices or deceptions, using a combination of the transaction and information methods. However, this variant of market manipulation is usually confused with the second variant, manipulation by false or misleading transactions, sometimes even with the misinformation variant.¹²⁰ A possible explanation might be that Article 1(2)(b) of Market Abuse Directive is designed to be a catch-all clause, so it is supposed to cover all manipulative behaviors which falls outside of the other three provisions.

The most classic technique used in this case is orders or transactions are made preceded or followed by dissemination of false or misleading information or investment recommendations by the same person.¹²¹ “Scalping”, pump and dump, and trash and cash (opposite of pump and dump) are typical instances given by the CESR guidance. In practices, the number of “scalping” perpetrated by investment advisors is quite impressive.

Article 5(b) of Directive 2003/124/EC provides that the person or person linked to him who makes orders or transactions before or after the dissemination of investment recommendation is possible involved in manipulation if the recommendations are

¹¹⁹ The first set of CESR guidance, paragraph 4.12.

¹²⁰ The manipulations by false or misleading transactions and by fictitious devices are treated in the same type that is manipulation by actions, or non-verbal communication. And “scalping” is considered as the typical case in the misinformation type. See Jesper Lau Hansen, “MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive” (2004), *European Business Law Review*, Issue 2, pp. 183–221.

¹²¹ Market abuse Directive, Article 1(2), second paragraph, Commission Directive 2003/124/EC, Article 5.

erroneous or biased or demonstrably influenced by material interest. None the less, what is a proper recommendation? Two elements are necessary: 1) information concerning the financial instruments to which that recommendation relates is fairly presented and, 2) interests or indicated conflicts of interest related are disclosed in a proper and efficient way.¹²² These criteria aim to ensure that, on the one hand, market participants' risk of manipulation is minimized, and on the other hand, a high level of recommendation will protect investor interest.

Another fictitious device popularly used in manipulation scheme is rumor. No matter true or false, the spreading of rumors causes damages to the market efficiency and investor confidence. Rumors reflecting true information may be caught by the insider dealing rules, while false rumors spread by opportunistic traders that gain from market prices being set at an artificial level fall into Article 1(2)(c).¹²³

2.4 Derogations to market manipulation prohibition

The definition of market manipulation in EU legislation covers a quite broad scope. In case of prohibition abuse, Article 8 of Market Abuse Directive, accompanied by Commission Regulation 2273/2003, designs two safe harbours: stabilisation and buy-back programmes. Different from other acts concerning market abuse, these two defences are provided in the Regulation, the direct effect of which ensures greater legal certainty in implementation and application throughout the EU. Except for these two derogations shared with insider dealing, Accepted Market Practices (AMPs) as another defence is stipulated in Article 1(2)(a) for some forms of manipulative activities.

Derogations to the market manipulation prohibition could greatly enhance market participants' confidence considering that behaviours carried out in accordance with the

¹²² Further details are provided in Commission Directive 2004/72/EC.

¹²³ Di Noia, Carmine and Gargantini, Matteo, "The Market Abuse Directive Disclosure Regime in Practice: Some Margins for Future Actions" (June 10, 2009), *Rivista delle Società*, No. 4/2009, 2009.

provisions do not bear the legal risk of being considered as abusive.¹²⁴ Meanwhile, behaviours which do not satisfy conditions set out in the rules are not deemed to constitute market manipulations; however, they should be examined in pursuit to the related rules.

2.4.1 Buy-back programmes

Buy-back programmes means repurchase of own shares by a firm.¹²⁵ It is an important but debatable issue in both company law and securities law, towards which the attitudes vary from one Member State to another. For those who oppose companies trading in own shares, they claimed that share buyback is a reduction of capital in essence, and therefore is against the principle of maintaining the capital provided in Directive 2010/30/EU.¹²⁶ Moreover, since the company has an absolute advantage of information about himself, it may perpetrate manipulative activities by trading its own shares.¹²⁷

However, those who support buy-back programmes believe that repurchase shares is an easy way to invest the surplus cash, to provide an exit-opportunity for shareholders (especially in merger process), to create additional demand for the firm's shares so as to maintain its price at level reflecting its real value, and to use as pension or compensation plans for employees.¹²⁸ The positive effects of trading in own shares are increasingly being recognized, and as a result, it becomes a permissive trend to accept or deregulate such transitions. Consistent with this trend, Market Abuse Directive adopts buy-back programmes as a justification for market abuse.

2.4.1.1 Purposes of buy-back programmes

¹²⁴ Di Noia, Carmine and Gargantini, Matteo, "The Market Abuse Directive Disclosure Regime in Practice: Some Margins for Future Actions" (June 10, 2009), *Rivista delle Società*, No. 4/2009, 2009.

¹²⁵ Regulation 2273/2003, Article 2(3).

¹²⁶ Directive 2012/30/EU repeals Directive 77/91/EEC, and it recognizes that corporate capital constitutes the creditors' security (recital 5).

¹²⁷ Jesper Lau Hansen, "MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive" (2004), *European Business Law Review*, Issue 2, pp. 183–221.

¹²⁸ See Nidal Rashid Sabri, "Using Treasury 'Repurchase' Shares to Stabilize Stock Markets", *International Journal of Business*, 8(4), 2003, pp. 425-450.

The scope of buy-back programmes provided in Regulation 2273/2003 is narrower than that in the company law, and its application should also comply with rules stipulated in Directive 2012/30/EU¹²⁹. In order to benefit from this exception, behaviours carried out should solely serve three objectives and be subject to certain trading restrictions and disclosure requirements. Firstly, the purpose of buy-back programmes only include three situations: reducing the capital of an issuer, meeting obligations arising from debt financial instruments exchangeable into equity instruments, or allocating shares to employees concerning employee share option programmes.¹³⁰

2.4.1.2 Disclosure requirements of buy-back programmes

Before the starting of trading, the company need a buy-back programme, in according to Article 21(1) of Directive 2012/30/EU, which comprises the objective, the maximum consideration, the maximum number of shares to be acquired and the authorised duration. Then the company must adequately disclose full details of the programme and subsequent changes, if there are, to the public in Member States in which it has requested admission of its shares to trading on a regulated market. Furthermore, during the execution of the programme, issuer must guarantee fulfilling its trade reporting obligation to the competent authority of regulated market on which the shares have been admitted to trade by certain mechanisms. And finally, such repurchases must be publicly disclosed no later than seven daily market sessions after the execution date.¹³¹

2.4.1.3 Restrictions of buy-back programmes

To start with, price restriction is stipulated in Article 5(1) of Regulation 2273/2003. The price that issuer repurchase its own shares or derivatives thereof must not be higher than the price of the last independent trade and the highest current independent bid on the

¹²⁹ Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.

¹³⁰ Regulation 2273/2003, Article 3.

¹³¹ Ibid, Article 4.

trading regulated market, no matter transactions are actually carried out or not on that trading venue.¹³²

In the second place, the buy-back programmes should, generally, set a trading volume restriction, which must be less than a quarter of “the average daily volume of the shares in any one day on the regulated market on which the purchase is carried out”.¹³³ But in particular situation, when the relevant market is extremely low of liquidity, the issuer could buy its shares more than 25% limit but less than 50% if adequate disclosure is made to the public and competent authority.¹³⁴

And finally, trading time restriction is used to forbid issuer to sell during the process of share buyback, or trade during the national trading market’s closed period issuer’s delayed inside information disclosure time. The trading time restrictions can be justified either in a time-scheduled buy-back programme or when investment firms or credit institutions has established effective information barriers (Chinese Wall) during certain time to ensure transactions made independent of the discretion of issuer.¹³⁵

In general, the conditions and restrictions set out for the application of buy-back programmes, on the one hand, aim to avoid abusive activities, as the repurchases of company will change the actual perceived value of asses of the firm;¹³⁶ however, on the other hand, the narrow scope of allowable purpose of repurchases, at the same time, significantly restrict the defence’s application in practice.

¹³² Regulation 2273/2003, Article 5(1).

¹³³ When mentioned in the programme, “the average daily volume figure must be based on the average daily volume traded in the month preceding the month of public disclosure of that programme and fixed on that basis for the authorised period of the programme”; when not mentioned, it “must be based on the average daily volume traded in the 20 trading days preceding the date of purchase”. See Regulation 2273/2003, Article 5(2).

¹³⁴ Ibid, Article 5(3).

¹³⁵ Ibid, Article 6(2) and (3).

¹³⁶ Arkadev Chatterjea, Joseph A. Cherian, and Robert A. Jarrow, “Market Manipulation and Corporate Finance: A New Perspective”, *Financial Management*, Vol. 22, No. 2, pp. 200-209, pp. 201 and 203.

2.4.2 Stabilisation

Stabilisation means activities of purchasing or selling of a security for maintaining the price at an equilibrium level.¹³⁷ Stabilisation *per se* is a market manipulative activity, which intends to induce potential investors to buy the offered security. Nevertheless, it is allowed in most countries considering the fact that such transitions could foster the distribution of the security, especially during Initial Public Offer (IPO), and promote the interest of issuers, underwriters, and shareholders.¹³⁸ Given the obvious risk that the underwriter might use its information and status advantages to benefit herself, strict limitations are provided in the Market Abuse Directive concerning the application of stabilisation.

Stabilisation is provided in Article 8 of Market Abuse Directive. It is defined as temporary price support activities through purchase or offer to purchase transferable securities or associated instruments equivalent thereto by an underwriter due to a selling pressure in such securities.¹³⁹ According to this definition, stabilisation as an exception to market manipulation does not include sell side trading, as it exclusively aims to prevent or retard the decline of the security price, which could only be achieved by purchases, rather than sells, of securities. However, this does not come to the conclusion that sell side trading is deemed as manipulative activities, which should be determined in pursuit of the Market Abuse Directive.¹⁴⁰

Given stabilization is a manipulative behaviour in nature, strict restrictions are imposed in order to avoid abusive application. Firstly, in terms of time limit, stabilisation should be carried out in a limited time after an initial or secondary offer of transferable securities. For shares and other securities equivalent to shares, it lasts no more than 30 calendar days

¹³⁷ The third set of CESR guidance and information on the common operation of the Directive to the market, paragraph 46.

¹³⁸ The US Securities Exchange Commission, release No. 34-38067, p.81.

¹³⁹ Commission Regulation 2273/2003, Article 2(7).

¹⁴⁰ The third set of CESR guidance and information on the common operation of the Directive to the market, paragraph 44.

starting from the date of trading in IPO¹⁴¹ or the date of adequate public disclosure of the securities' final price in the secondary offer. For bonds and other forms of securitised debt, the stabilizing time begins when adequate public disclosure of the terms of the offer of the relevant securities,¹⁴² and ends either no more than 30 calendar days after the date on which the proceeds of the issue are received by the issuer or no more than 60 calendar days after the allotment.¹⁴³

Secondly, stabilisation is also subject to specific price conditions. Underwriters should not buy shares or equivalent instruments at a price more than the offering price or, when concerning convertible or exchangeable debts, the boundary is the market price at the disclosure time of new offer's final terms.¹⁴⁴

And finally, two adequately public disclosures are required. One is made before the opening of the offer period of the relevant securities, with regard to stabilizing information such as the existence, objective, beginning and end time, identity of the stabilisation manager and the maximum size of any overallotment facility or greenshoe option if there is. The other disclosure is made one week at the end of the stabilisation period, mainly about the execution time and price. For better regulation of stabilisation, every detail of the stabilisation transactions should be reported to the competent authority issuers, offerors, entities undertaking the stabilisation, or persons on behalf of them.¹⁴⁵

Furthermore, ancillary stabilisation, which involves overallotment facility or "greenshoe option", in addition to disclosure requirements provided in Article 9 of Regulation 2273/2003, should be executed only during the subscription period and at the offer price,

¹⁴¹ If the trading is permitted before the commencement of trading on a regulated market, the start time is the date of adequate disclosure of the security's final price. Ibid, Article 8(2).

¹⁴² For the convertible or exchangeable debts, "the terms" refer to "the final term".

¹⁴³ Commission Regulation 2273/2003, Article 8.

¹⁴⁴ Ibid, Article 10.

¹⁴⁵ Ibid, Article 9.

and be restricted to 15% of the original offer size for greenshoe option and 5% of the original offer for naked short position.¹⁴⁶

2.4.3 Accepted Market Practices

AMP is not a safe harbour like buy-back programmes or stabilisation. It is the “*behaviour when dealing in financial markets that can reasonably be expected in one national market, for example, due to local, long-established customs while potentially constituting market abuse in others.*”¹⁴⁷ It serves to avoid punishing activities that could foster innovation and continued dynamic development in capital market caused by the broad scope of Article 1(2)(a) of Market Abuse Directive.

Even though AMP has the appearance of manipulation, it could be justified if certain circumstance and conditions are satisfied.¹⁴⁸ For benefiting from this derogation, a person involving in speculative practices should establish that 1) he has a legitimate reason to make such transactions or bids and, 2) his transactions or bids conform to accepted market practices on the regulated market concerned.¹⁴⁹ Since the adoption of Market Abuse Directive in 2003, 10 AMPs have been issued by 8 Member States. 6 of the total 10 AMPs are concerning “liquidity contracts”, allowing listed companies or closed-end collective investment schemes to arrange contracts with investment service providers mainly for stabilizing price fluctuations.¹⁵⁰

However, AMPs generate several issues in practice. First of all, AMP defence is neither available in the absence of legitimate purpose, nor applicable when legitimate and illegal reasons are at the same time behind the manipulator’s conducts. Further question rises

¹⁴⁶ Ibid, Article 11.

¹⁴⁷ Commission staff working paper, Impact Assessment, SEC(2011) 1217 final, p. 28.

¹⁴⁸ CESR, Frequently Asked Questions: Accepted Market Practices, Reference 05-365.

¹⁴⁹ Market Abuse Directive, Recital 20 and Article 1(2)(a).

¹⁵⁰ The six AMPs about “Liquidity Contracts” come from France (2), Austria, Spain, Portugal, Greece, Italy and Netherland. Also both Greece and France issue an AMP about purchase of own shares to hold them for future acquisition of shares of another company. The other two are from the UK concerning market aberrations on the London Metal Exchange and Austria with regard to valuation transaction on the bond market on the Vienna Stock Exchange. Details of each AMP are available at <http://www.esma.europa.eu/page/accepted-markets-practices>.

concerning the interpretations of “legitimate reason”. Could the compliance with accepted market practices *per se* be presumed as having legitimate reason? No answer can be founded in relevant legislations or guidance.¹⁵¹

In the second place, AMP is a national discretion, the constitute elements of which are decided by national legislations. Therefore, these elements vary among Member States considering different market size or supervisory rules. This raises a common concern. Significant legal uncertainty is generated for multi-listed issuers or intermediaries operating in multiple markets, because costs increase for the person who cannot do exactly the same practices in different markets that allow different AMPs.

2.5 Liability regime of market manipulation

Imposing suitable liability would, to a large degree, deter market participants from perpetrating manipulative activities. Generally speaking, civil, criminal and administrative liabilities are used to punish participants’ misconducts, in order to enhance market integrity and to increase investor confidence in different countries’ financial markets. Nevertheless, only administrative liability is harmonised at a minimum level in Market Abuse Directive, the other two are totally up to the decision of Member State.

Before entering into force of Market Abuse Directive, not all regulators in the Member States had the right to impose administrative sanctions on manipulators. Administrative sanctions are considered as an effective way for preventing market manipulation by the EU legislations, and therefore, a harmonisation has been made.

¹⁵¹ In the article written by Panagiotis K. Staikouras, compliance with an AMP is considered to have legitimate reason, and he argued that the two elements of AMP should be merged into one (ie, that of an accepted market practice). Panagiotis K. Staikouras, “Four Years of MADness? – The New Market Abuse Prohibition Revisited: Integrated Implementation through the Lens of a Critical, Comparative Analysis” (2008), 19 *European Business Law Review*, Issue 4, pp. 775–809.

2.5.1 An general requirement of administrative sanctions

Article 14 of Market Abuse Directive provides a general harmonisation of administrative sanctioning regime in the EU. Firstly, appropriate administrative measures or sanctions should be imposed against the manipulators covered by the Directive and the persons who fail to cooperate in such investigation. Secondly, those measures or sanctions should be effective, proportionate and dissuasive. And lastly, the competent authority should disclose such administrative measures or sanctions unless this would seriously jeopardize the financial markets or cause disproportionate damage to the related parties.¹⁵²

Administrative sanctions could be imposed on be both natural and legal person by competent authority, while the former is relatively higher punished than the number of the latter from 2008 to 2010.¹⁵³ And those measures imposed include pecuniary and non-pecuniary sanctions, such as reprimand or warning, temporary disqualification, and withdrawal of licenses.¹⁵⁴ Moreover, most competent authorities managed to use serious, specific and convergent evidence to prove market manipulation in the absence of tangible proof.¹⁵⁵

2.5.2 The constructive elements of administrative liability

In order to imposing administrative measures on suspects of manipulative activities, the competent authorities need to prove:

(a) There is one or more manipulative acts, which could be false or misleading trading, price positioning, transactions involving fictitious devices, or dissemination of false or misleading information provided in Article 1(2) of Market Abuse Directive;

(b) Intent, “*the person who made the dissemination knew, or ought to have known, that the information was false or misleading*”,¹⁵⁶ is a necessary element only for determination of manipulation by dissemination of false or misleading information. Since market

¹⁵² Market Abuse Directive, Article 14.

¹⁵³ ESMA Report, “Actual Use of Sanctioning Power under MAD”, paragraph 35 and 38, pp.12-13.

¹⁵⁴ Ibid, paragraph 39-42, p.13.

¹⁵⁵ Ibid, paragraph 42, p. 13.

¹⁵⁶ Market Abuse Directive, Article 1(2)(c).

manipulation is defined by the effect-based approach, there is no need to prove whether the intention of the manipulative is to induce other investors to trade.¹⁵⁷

(c) The price of, supply of or demand for financial instruments is effected by perpetrator's activities; and

(d) There is causation between the manipulative act and the price or supply and demand changes. Whether the person, except journalists, deriving, directly or indirectly, an advantages or profits his act is irrelevant with the imposition of sanctions.

However, there are some issues concerning the administrative sanctioning regime. To begin with, difficulties exist in establishing links between market acts and outcomes, especially in the situation which requires an element of intention to be established.¹⁵⁸ Also, the concept of "artificial or abnormal price" is obscure, so further interpretation is needed for a uniform application in the EU.

And the last issue that deserves more words is about the derogations to manipulation by fictitious devices or deception. As mentioned before, this form of manipulation is designed as a catch-all type, so it is quite flexible and broadly applicable, or even may "overlap with the previous two categories in several respects"¹⁵⁹. Although fictitious devices manipulation is also defined by the effect-based approach as fictitious or misleading trading or price positioning manipulation, it is not given the same derogation, AMPs. For this reason, it is quite risky that conducts, in particular the new developed and aggressive ones, may fall within the prohibition even if legitimate.

2.6 Preventive measures of market manipulation

Like the old adage says, preventing is better than curing. Efficient preventive measures will significant reduce the number of potential manipulation by cutting down the social

¹⁵⁷ Intent was not a requirement to prove a manipulative practice within administrative sanction proceedings in 24 Member States from 2008 to 2010. See ESMA Report, "Actual Use of Sanctioning Power under MAD", paragraph 42, p. 13.

¹⁵⁸ ESMA Report, "Actual Use of Sanctioning Power under MAD", paragraph 36, p.12.

¹⁵⁹ CESR, "Advice on Possible Level 2 Implementing Measures for the Proposed Market Abuse Directive", Reference CESR/02-089b, paragraph 66.

costs with regard to the detection or investigation of suspicious cases. And they could also enhance regulator's enforcement efficiency considering useful information provided by insiders of a manipulator. Hence, a couple of preventive measures are provided in the market manipulation regime in EU.

2.6.1 Continuous disclosure obligation

Continuous disclosure obligation (or on-going disclosure obligation) is imposed on issuers in Article 6 of Market Abuse Directive, serving an ex-ante prophylactic function and working in tandem with ex-post enforcement and investigation framework.¹⁶⁰ Combined with the disclosure regime provided in Directive 2004/109/EC (also known as Transparency Directive)¹⁶¹, it aims to ensure related information is provided to investors efficiently, accurately and timely. This will reduce the chance of spreading false or misleading information, and as a result, provide less opportunity for perpetrating manipulation.

2.6.2 Obligations of market operators and professional organizations

Except from issuers, market operators and professional organizations also have the obligation to prevent market manipulation. According to Article 6(6) of the Market Abuse Directive, market operators are required to adopt structural provisions, such as requirements concerning transparency of transactions concluded, total disclosure of price-regularisation agreements, and clear rules concerning transaction suspension, in order to prevent and detect market manipulation practices.¹⁶²

Furthermore, several prophylactic measures are recommended to professional economic actors, including "Chinese wall", internal codes of conduct and other means aiming at combating market manipulations. In particular, the transaction reporting requirement

¹⁶⁰ Niamh Moloney, *EC Securities Regulation*, Oxford University Press (2008), 2nd edition, p. 967.

¹⁶¹ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

¹⁶² See Market Abuse Directive, Article 6(6) and Recital 27.

provided in MiFID¹⁶³ contributes to deter manipulative practices. However, these measures are not compulsory, so it depends on the national law and choice of the professionals.

2.6.3 Suspicious transaction reports

The most important preventive measure introduced by Market Abuse Directive is suspicious transaction reports, which is also popular known as whistle-blower regime. Taking consideration of the large size and complexity of current financial markets, it is impossible for competent authorities to detect all possible manipulative practices. Therefore, useful information and evidences concerning suspicious transitions provided by reporters will play an effective role in helping regulators to detect more breaches that may have gone unnoticed, which has been proved in market manipulation investigation.¹⁶⁴

Suspicious transaction reports means that entities responsible for reporting suspicious transactions are the persons professionally arranging transactions. This regime is provided by Article 6(9) of Market Abuse Directive, Articles 7 to 11 of the Directive 2004/72/EC, part 5 of the first set of CESR guidance and part 2 of the third set of CESR guidance. According to related rules, some conditions are set out to ensure the efficiency of such reports. Firstly, the responsibility of a person to report doubtful trading is a case-by-case decision, but it's certain that investment firms or credit institutions should do so.¹⁶⁵

Secondly, a reasonable suspect should be established when a person make notification to the competent authority.¹⁶⁶ In terms of the criteria for determining the notifiable transactions, as recommended by CESR, an unexecuted trading order, on equity or non-equity regulated markets, raising suspicion of market manipulation shall be reported

¹⁶³ MiFID, Article 25(3): "Member States shall require investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to *report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day. This obligation shall apply whether or not such transaction were carried out on a regulated market...*"

¹⁶⁴ The third set of CESR guidance and information on the common operation of the Directive to the market, Reference CESR/09-219, p.8.

¹⁶⁵ Market Abuse Directive, Article 6(9), and Directive 2004/72/EC, Article 1(3).

¹⁶⁶ Generally speaking, the notification should be made to the competent authority in home Member State. But for branches, it is the competent authority in host Member States. Directive 2004/72/EC, Article 7.

to the competent authority when it is not already legally required on a national basis.¹⁶⁷

With regard to the contents of such notification, “*any information which may have significance in reviewing the suspicious transactions*”¹⁶⁸ should be reported and a non-exhausted and purely indicative list of examples is provided by ESMA¹⁶⁹.

Last but not least, in order to protect the person notifying suspicious transaction, the reports in good faith to the competent authority do not fall within professional secrecy and the competent authority should not disclose this person to anyone in case he would be harmed.¹⁷⁰ The protection of reporter’s identity and privacy will keep them from retaliation, and encourage such actions.

2.7 Supervision regime of market manipulation

While EU now is the main rule maker of financial markets, supervision has long been the competence of Member States since outset.¹⁷¹ Supervision of market manipulation in the EU financial markets is generally based on two principles: the home State control principle, which determines the authority competent to ensure supervision, and mutual recognition principle, which guarantees the decisions of home State competent authority being recognized by the host country.¹⁷²

Market Abuse Directive makes endeavours to ensure a minimum degree of supervisory coordination and to allocate supervisory jurisdiction. However, with the arrival of European Securities and Market Authority (hereinafter referred as ESMA) in January

¹⁶⁷ The third set of CESR guidance and information on the common operation of the Directive to the market, Reference CESR/09-219, pp.8-9.

¹⁶⁸ Directive 2004/72/EC, Article 9(1)(e).

¹⁶⁹ The third set of CESR guidance and information on the common operation of the Directive to the market, Reference CESR/09-219, paragraph 29-30.

¹⁷⁰ Directive 2004/72/EC, Article 11.

¹⁷¹ Niamh Moloney, “The European Securities and Markets Authority and Institutional Design for the EU Financial Market- A Tale of Two Competences: Part (2) Rules in Action” (2011), *European Business Organization Law Review*, 12, pp. 177-225.

¹⁷² Pierre Schammo, “The European Securities and Market Authority: Lifting the Veil on the Allocation of Powers”, *Common Market Law Review* 48, 2011, pp. 1879-1914.

2011, the supervision system in securities markets has been changed dramatically. This new EU level supervisor plays a much more active role in supervisory area.

2.6.1 Supervisory authority and its powers

Considering the fact that regulatory authorities in Member States are of different responsibilities or powers will create confusion among economic actors,¹⁷³ Market Abuse Directive requires that each Member State shall have a competent authority that is responsible for international collaboration and supervisory cooperation. According to the Directive, competent authority should be administrative nature, and has appropriate financing guaranteed by Member States. Consequently, they are more independent compared with economic actors considering the chance to avoid conflicts of interest.¹⁷⁴

In order to ensure supervisory effectiveness, a common minimum set of effective tools and powers for the national competent authorities is provided in Market Abuse Directive.¹⁷⁵

Competent authorities shall, at least, have: (a) investigatory powers, including having access to any document and receiving copies, demanding information from any person, requiring existing telephone number and existing data traffic records; and making on-site inspections;¹⁷⁶ (b) supervisory measures, covering the cessation of any practices failing to comply with provisions in the Directive, suspending related financial instruments' trading, requesting the freezing and/or sequestration of assets, and temporary prohibiting the professional activities.¹⁷⁷

However, Market Abuse Directive only makes a minimum harmonisation concerning powers of competent authorities, so different competent authorities still have substantial differences on the powers granted to them, *“both in respect of what they can do by ways of*

¹⁷³ Market Abuse Directive, Recital 36.

¹⁷⁴ Ibid, Recital 36 and Article 11, paragraph 1.

¹⁷⁵ Market Abuse Directive, Recital 37.

¹⁷⁶ Ibid, Article 12(2)(a)(b)(c)(d).

¹⁷⁷ Ibid, Article 12(2)(e)(f)(g)(h).

supervision and in respect of the enforcement actions (including sanctions) open to them when a firm is in breach of its duties”¹⁷⁸.

Furthermore, certain obligations concerning supervision are also provided for Member States and their competent authorities in Market Abuse Directive. The first one is that all persons, who have access to information during the exercise of professional duties related to the powers mentioned before, are subject to the obligation of professional secrecy. Such information covered by professional secrecy should not be disclosed unless in conformity with legal provisions.¹⁷⁹ The other one is that judicial remedy for administrative decisions should be provided.¹⁸⁰ These rules aim to prevent regulators and their officers from abusing powers, and offer a legal basis for seeking compensation in case it happens.

2.6.2 Supervisory cooperation mechanism

With the integration of financial markets in EU, the number of cross-border activities increases dramatically, which provide more opportunities for cross-border manipulation. Such kind of manipulative activities is hard to detect or punish by single supervisors. Therefore, cooperation among different parties becomes an essential requirement for establishing an efficient supervisory system for combating market manipulation. Market Abuse Directive has created a supervisory cooperation mechanism, which requires competent authorities in Member States to exchange information and to cooperate during investigation of market manipulation.

The cooperation between national competent authorities is the foundation of EU market manipulation supervision. According to Article 16 of Market Abuse Directive, national competent authorities have the obligation to cooperate with each other whenever necessary in order to deliver their duties. Two most important ways to assist each other are information exchange and cooperation in investigation activities.

¹⁷⁸ Report by the High-Level Group on Financial Supervision in the EU Chaired by Jacques de Larosière (Feb. 25, 2009) (hereinafter de Larosière Report), available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf, last visited on 5 March 2015.

¹⁷⁹ Market Abuse Directive, Article 13.

¹⁸⁰ Ibid, Article 15.

On the one hand, competent authority in one Member State should immediately gather and provide the information required by the other competent authority. If it fails to do so, justified reasons need to be provided. And intervention at EU level will also be made in the situation that request for information is rejected or no action is taken within a reasonable time.¹⁸¹

On the other hand, investigation of market manipulation is based on the principle of home Member State control. A competent authority shall notify the home State's competent authority the fact that such misconducts is being carried out in the latter's territory if he requires investigatory cooperation. The requiring competent authority may ask the home supervisor to have its personnel to follow the investigation. But the home Member State's competent authority has the right to refuse such accompany if statutory reasons are provided; vice versa, it will be intervened by related EU authority.

Furthermore, the EU supervisory authority plays as an arbitrator between competent authorities. It has the right to organize a discussion of national supervisors to settle disagreements between them when there is a refusal of information exchange or investigatory cooperation. Such discussion is taken place in order to reach a rapid and effective solution.¹⁸² However, the result of the discussion is not binding, which reduce the efficiency of this process.

In wake of the global financial crisis, the cooperation system established by the Market Abuse Directive is proved to be inefficient. A financial supervisory reform is made and new EU supervisory authorities have been instituted. In terms of regulation of the securities market, ESMA takes the place of CESR, and the new powers of ESMA greatly enhance the effectiveness of the supervisory cooperation mechanism. Further details concerning changes made will be discussed in Chapter 4.

¹⁸¹ Market Abuse Directive, Article 16(2).

¹⁸² Market Abuse Directive, Article 15(2) and (4)

Conclusion of Chapter 2

Market manipulation regulation in EU is a success in general. The Market Abuse Directive and its implementing acts have realized their main objectives of enhancing financial market integrity and public confidence in the financial markets. A clear definition of market manipulation is provided by the EU legislation, which is further elaborated by possible signals and typical examples. This definition not only could covers manipulative practices that may come out in the future, but also help market participants and supervisors to understand what this hard concept means. In order to avoid overly prohibition, EU regulation stipulates two safe harbours, buy-back programmes and stabilisation, for all abusive actions and Accepted Market Practices (AMPs) for two specially forms of market manipulation.

For a better supervision and enforcement, administrative liability of market manipulation is harmonised, and different constituent elements for different forms are also provided in the relevant regulations. Furthermore, a couple of preventive measures in the market manipulation regime, especially suspicious transaction reports, contribute to the deterrence of illegal behaviours in the financial market. And finally, a convergence supervision regime is stipulated. Competent authorities in Member States are designed and certain powers are granted to them to ensure a better supervision on manipulations.

However, further improvements concerning the market manipulation regulation should be made. Definition of market manipulation is not totally clear, as the distinction between different forms is ambiguous at some degree. And some types of manipulation have overlaps, but they do not enjoy the same derogations. Further, AMPs vary form Member State to Member State, which would cause confusion for market participants and then decrease their willingness to do cross-border activities. Moreover, the deficiencies of liability and supervision regime may affect the efficiency of manipulation rules. All these show the necessity of a reform to the current market manipulation regulation, and details of the reform will be discussed in the Chapter 3 and Chapter 4.

Chapter 3 Reform of the EU Market Manipulation Regime: Part (1) reasons of the reform and legal framework changes

Market Abuse Directive has played an important role in combatting market manipulation and insider dealing since it came into force in 2004. The harmonised regulation is generally considered as a success for protecting the reasonable function of financial market and for enhancing investors' confidence.¹⁸³ Although significant improvements have been made by this Directive, the current market manipulation regulation is not sufficiently effective, in particular given the role that manipulative behaviours played in the global financial crisis.¹⁸⁴

Therefore, a review of market manipulation regulation (also the whole market abuse regulation) was initially undertaken by the European Commission in 2007, after CESR published the '*Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive*' at the request of the Commission. Then two public consultations were launched on 20 April 2009 and 28 June 2010 respectively. Taking into account of the contributions collected from interested parties and report proposed by ESME, proposals for a *Regulation on insider dealing and market manipulation (market abuse)* (Market Abuse Regulation), and for a *Directive on criminal sanctions for insider dealing and market manipulation* were adopted by the Commission on 20 October 2011.

Then, in the wake of the Libor scandal, the prohibition of benchmarks manipulation is proved to be necessary, so amendments concerning such prohibition are made in the draft Regulation and Directive on 25 July 2012. And finally, Regulation No 596/2014 on market abuse (Market Abuse Regulation) and Directive 2014/57/EU on criminal sanctions

¹⁸³ See ESME Report: "Market abuse EU legal framework and its implementation by Member States: a first evaluation", available at http://ec.europa.eu/internal_market/securities/docs/esme/mad_070706_en.pdf.

¹⁸⁴ According to a research lead by Professor Yaneer Bar-Yam, President of New England Complex Systems Institute (NECSI), and his team, direct evidence about connection between market manipulation and the financial crisis in November 2007 could be found. See Vedant Misra, Marco Lagi, and Yaneer Bar-Yam, "Evidence of market manipulation in the financial crisis", arXiv:1112.3095 [q-fin.GN].

for market abuse (Market Abuse Directive) were published in the EU Official Journal on 22 June 2014. The Market Abuse Regulation shall enter into application in July 2016, while the Directive on criminal sanctions for market abuse will be transposed into national law by Member States in two years.

The new package of market abuse regulations shares the same aims as Market Abuse Directive, namely to ensure the integrity and transparency of the EU financial markets and to enhance investor confidence. However, it keeps pace with market developments, updates and strengthens the existing framework to guarantee the realization of these objectives.¹⁸⁵

3.1 Why market manipulation regime needs to be reviewed in EU?

3.1.1 Regulatory gaps as the developments of new trading platforms and technologies

3.1.1.1 Market fragmentation leads to regulatory gaps

Current market manipulation regulation only covers an instrument, which is admitted to trading on a regulated market, no matter on which platform its real transactions are carried out.¹⁸⁶ It means that a trading will not be caught by the prohibition, if the instrument is not admitted to trade on a regulated market but is only traded on a Multilateral Trading Facilities (MTF), Organized Trading Facilities (OTF, such as swap execution facilities or broker crossing systems) or Over-The-Counter (OTC).¹⁸⁷ At the time when Market Abuse Directive was adopted, regulated market is in the dominant position for trades of financial instruments. Unfortunately, this situation has changed in the past few years, particularly after the adoption of MiFID. New emerging trading platforms attract more and more investors and capital raisers than before, thus, the dominant status of traditional trading venues were threatened.

¹⁸⁵ European Commission, Daily News on 12 June 2014, EXME 14 / 12.06.

¹⁸⁶ Market Abuse Directive, Article 9.

¹⁸⁷ Commission staff working paper, “Executive Summary of the Impact Assessment”, SEC(2011) 1218 final, p. 2.

For example, traditional exchanges or regulated markets accounted for around 60% of the total distribution of trading in the European market in 2008, whereas at the end of 2011, this number dropped to about 45%. In the meantime, MTF has acquired near 15% percent of the business in three years with the advent of MiFID. Besides, OTC-trading represented a high and stable market share around 40%.¹⁸⁸ Not to mention the international derivatives, the total amount of trading volume on OTC market is 6 times more than that on exchanges from January 2008 to November 2011. What's more, a notable number of shares and bonds, which fall outside the regulation of market manipulation as they are not listed on the exchanges, only trades on MTFs.

As a result, financial instruments only traded on non-regulated markets are particularly susceptible to market manipulation. For example, according to the annual report published by German competent authority, German Federal Financial Services Authority (BaFin), at the beginning of June 2011, this category of cases represented over 90% of market manipulation cases investigated, compared with 69% in the previous year.¹⁸⁹ Therefore, with the increasing importance of MTF, OTF and OTC, the current regulatory scope of trading platforms is not sufficient to ensure an even playing level and protection of investor's confidence.

3.1.1.2 Increasing cross-market trades increase regulatory pressure

In order to satisfy various needs of capital raisers and investors, rules of different types of trading platforms concerning prospectus, information disclosure and surveillances vary from each other. Yet the connections between different platforms are becoming much closer with the development of derivative products. And this increases the possibility of

¹⁸⁸ Peter Gomber, Björn Arndt, Marco Lutat, and Tim Uhle, "High-Frequency Trading", p.11, available at http://safe-frankfurt.de/uploads/media/Gomber_et_al_High_Frequency_Trading.pdf, last visited on 4 March 2015.

¹⁸⁹ Freshfields Bruckhanus Deringer, European Market Abuse News, summer 2011, available at <http://hb.betterregulation.com/external/European%20market%20abuse%20news%20-%20July.pdf>, last visited on 4 March 2015.

market manipulation, as a potential manipulator may take advantage of less stricter rules in one trading platform to affect another.

For example, a manipulator could succeed to use a derivative instrument traded on OTC, such as credit default swap (CDS), which is not covered by Market Abuse Directive, to manipulate a related financial instrument covered by the Directive on an exchange.¹⁹⁰ Unfortunately, such situation does not fall into prohibition of market manipulation according to Market Abuse Directive.

3.1.1.3 New technologies make market manipulation harder to detect

The technological innovations not just help the financial market to become more economic and efficient, but also make it more complex and harder to supervise. The universal adoption of automate trading methods in European financial markets, in particular algorithmic trading or high frequency trading (HFT), requires the Union and national competent authorities to have specific arrangements or regulation to ensure the prevention of market abuse.¹⁹¹ For instance, Germany adopted the High-Frequency Trading Act on 28 February 2013, which provides specific regulatory requirements for algorithmic and high frequency trading.¹⁹²

HFT is a quite fiercely discussed topic, raises a lot of concern on the automated trading forms. It is a type of algorithmic trading, typically not a strategy *per se* but a usage of very sophisticated technology to implement traditional trading strategies, such as arbitrage and market making strategies. HFT is relatively new and does not have a uniform definition¹⁹³, which, if carried out, is likely to constitute market abuse. According to the guideline issued

¹⁹⁰ See Commission, Commission Staff Working Paper Impact Assessment, Brussels, 20.10.2011 SEC(2011) 1217 final, p. 13.

¹⁹¹ ESMA Guidelines, ‘Systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities’, ESMA/2012/122 (EN), P. 16.

¹⁹² Relevant information is available at http://www.bafin.de/EN/Supervision/StockExchangesMarkets/HighFrequencyTrading/high_frequency_trading_artikel.html, last visited on 4 March 2015.

¹⁹³ HFT is simply defined as “professional traders acting in a proprietary capacity that engage in strategies that generate a large number of trades on a daily basis” by the SEC. Securities and Exchange Commission, “Concept Release on Equity Market Structure”, 17 CFR PART 242, Release No. 34-61358, p. 45.

by ESMA, market manipulation is very likely to happen in four cases: ping orders, quote stuffing, momentum ignition, layering and spoofing.¹⁹⁴

Although HFT contributes to increase market liquidity, to reduce volatility in most circumstances and to enhance price discovery, it is also responsible for *May 2010 flash crash*, *knight Capital case* in the US, and the Norwegian *Robot case*. Currently, about 30% of all activity is operated by HFT in European equity markets¹⁹⁵, so it is wise to elaborate market manipulation regime to make sure manipulations through HFT could be correctly treated.

3.1.2. Gaps in the regulation of commodity markets and commodity derivatives markets

Manipulation may take place on commodity markets and related commodity derivatives markets.¹⁹⁶ An introduction of market manipulation prohibition for physical is recommendable, considering the damages made by manipulators in the market.¹⁹⁷ However, it is not wise to apply the same rules for commodities manipulation and securities manipulation. On the one hand, the functions of financial market and physical

¹⁹⁴ “***Ping orders*** means entering small orders in order to ascertain the level of hidden orders and particularly used to assess what is resting on a dark platform. ***Quote stuffing*** means entering large numbers of orders and/or cancellations/updates to orders so as to create uncertainty for other participants, slowing down their process and to camouflage their own strategy. ***Momentum ignition*** means entry of orders or a series of orders intended to start or exacerbate a trend, and to encourage other participants to accelerate or extend the trend in order to create an opportunity to unwind/open a position at a favourable price. And ***Layering and Spoofing*** mean submitting multiple orders often away from the touch on one side of the order book with the intention of executing a trade on the other side of the order book. Once that trade has taken place, the manipulative orders will be removed.” Securities and Exchange Commission, “Concept Release on Equity Market Structure”, 17 CFR PART 242, Release No. 34-61358, pp. 16-17.

¹⁹⁵ Philip Stafford, “Europe agrees on high-speed trading regulation”, *Financial Times*, October 22, 2013.

¹⁹⁶ ‘Commodity’ means any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity. Commission Regulation (EC) No 1287/2006 of August 2006 implementing Directive 2004/39 of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instrument to trading, and defined terms for the purposes of that Directive. [OJ L 124, 2.9.2006, p. 1]

¹⁹⁷ See JP MORGAN case and Goldman Sachs and the other big banks case, BATR, “J P Morgan and Commodity Manipulation”, Jul 31, 2013, available at <http://www.marketoracle.co.uk/Article41656.html> and “How the Commodities Market is Manipulated: A look at how Goldman Sachs and other big banks manipulate the commodities market, with a focus on aluminum”, posted on 27 Jul 2013, available at <http://www.equedia.com/how-the-commodities-market-is-manipulated/>.

market and related derivatives market are quite different from each other.¹⁹⁸ And on the other hand, rules of the commodity markets need to be made according to different characters of commodities, in particular for the energy market.

Nevertheless, interconnections between commodity markets and related financial markets are highly strong. Illegal benefits could be made by using important information of a spot market to speculate the price of an instrument traded on a financial market. This means that investors in commodity derivatives may be less protected than investors in derivatives traded on financial markets, as the Market Abuse Directive does not apply to transactions of commodities and related derivatives, except those derivatives which are admitted to trade on a regulated market.¹⁹⁹ The ignorance of significant influence from physical markets on financial markets is, therefore, considered as a big loophole in market manipulation regulation. This becomes one of the most important parts of the Market Abuse Directive review concerning whether and how to introduce a suitable market manipulation framework for physical markets.

3.1.3 Unclear and impropriety in market manipulation regime

Market Abuse Directive gives a large scope of options and discretions for Member States to implement it, which has led to uniform and ambiguous applications. This situation is worsened by the fact that Market Abuse Directive's adoption did not benefit from useful public consultations that may help EU acts to reduce inconsistencies in enforcement. In order to create an integrated market manipulation regime in EU, those unclear and ambiguous rules should be identified and amended.

3.1.3.1 The definition of market manipulation is partially unclear

¹⁹⁸ 'Future markets perform price discovery for various market participants who buy or sell a commodity on the cash market.' And the securities markets serve as a platform for raising capital through the initial public offerings of their securities and creating liquidity in order to execute customers' orders to buy or sell securities at a price related to the price of the preceding transaction. See Amanda N. Miller, 'Securities and commodities manipulation: Is there a principled reason to distinguish the two?', 17 No. 1 PIABABJ 1., P. 3.

¹⁹⁹ See Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) (Market Abuse Regulation), Recital 15, p. 17.

It is at large a success for EU legislation to give a formal definition of market manipulation. Despite the fact that this concept is defined in a wise way, combining a general definition with detailed sub-definitions, confusions still exist. The first problem is concerning overlaps among sub-definitions. Manipulation only based on transactions or orders provided in Article 1(2)(a) of the Market Abuse Directive and manipulation based on fictitious devices or other forms of deception provided in Article 1(2)(b) are both defined by the effect-based approach. In practice, these two categories of manipulations cover a large-scale of misconducts. For avoiding the punishment of desirable activities in the financial markets, except from buy-back programmes and stabilization, AMP as a special derogation is provided for the former category, while the latter one could not benefit from it. Accordingly, a behaviour, which has caused influence of a financial instrument through execution of transactions or placing orders without intention to manipulation, might also be caught by current regulation.

Also, scalping perpetrated by investment advisors through recommendation is commonly considered as a typical example of information-based manipulation in other countries and illegal intention of manipulating financial instrument is an essential element of such manipulation. Since investment advisors are not insiders, their recommendation or analyst is made basing on public resources and their own abilities, which is impossible to avoid mistakes. So it is necessary to consider the intention of a perpetrator when making a judgment. As a result, it is better for balancing prohibition of manipulation and protection of investment advisors if this form of manipulation is provided in Article 1(2)(c) rather than Article 1(2)(b), in pursuit of which intent of inducing trading is not a necessary condition.

The second problematic issue is with regard to unclear key concepts. Article 1(2)(a) stipulates that transactions or orders to trade which “secure” the price of one or several financial instruments at an “abnormal or artificial level” should be prohibited. The interpretation of “secure” is disputable in practice. Given that the price of a financial

instrument could be influenced by various elements, it is very hard to verify that the price is “secured” at an abnormal or artificial level by manipulative behaviours. With the advanced technologies, trades of investment instruments could be transited within seconds, so the artificial or abnormal prices may just be set in a very short time. A few seconds is enough for manipulators to get illegal profits, while it is difficult for the regulators to collect evidence. Therefore, in order to fall within Article 1(2)(a), whether it requires the price of one or more financial instruments which considered to have been fixed at an abnormal or artificial level, must maintain an abnormal or artificial level for more than a certain duration.

This question is answered by the Court of Justice of European Union (CJEU) in the case of *IMC Securities*²⁰⁰. CJEU ruled that securing the price of the financial instrument or instruments does not need to maintain it at an abnormal or artificial level for more than a certain duration, and it is sufficient if the speculative conduct *“has led to the setting of the price of one or more financial instruments at an abnormal or artificial level in order for it to come within the meaning of market manipulation.”*²⁰¹

Another key concept is concerning “abnormal or artificial level or price”. This concept is in the central for defining market manipulation based on trading or orders, however, neither the EU legislation nor case law of CJEU has ever tried to give a clear answer. And the last critical concept is “false or misleading information”. What are the criteria of “misleading”? Is the factually correct information included? Whether rumour falls within such kind of information? All these issues could not find satisfied solution in current market manipulation regulation.

²⁰⁰ CJEU, Case C-445/09. In this case, the applicant, IMC, a Netherlands securities firm, realized a profit of almost 10% of total trading value within a few minutes through two successive trading orders and partial transactions which decreased the trading price of the financial instrument from around 81euro to 73 euro. The manipulative price, 73 euro, lasted no more than one second and then returned to normal level (around 80.5 euro).

²⁰¹ *Ibid*, paragraph 26-29.

As these key concepts concerning market manipulation are not clearly provided by the EU legislations, Member States have many differences during their implementations, and therefore the uniformity of the EU market manipulation regime is affected.

3.1.3.2 Derogations for market manipulation are quite arguable

In terms of buy-back programs, the major argument focuses on its narrow legal intention. In order to benefit from this safe harbour, only three purposes of shares repurchases are permissible, which are reducing the issuer's capital, meeting obligations arising from debt financial instruments exchangeable into equity instruments, or allocating shares to employees concerning employee share option programs. This scope is narrower than that provided in company law. As a result, many private parties strive for adding more legal reasons to buy-back programs, such as delivering the payment of dividends through shares to shareholders, or purchasing own shares to hold them for future merger or acquisition, which is an AMP in Greece and France.²⁰²

With regard to the other safe harbour, stabilization, its various applications among Member States is the central issue. Even though stabilization is provided in regulation with direct binding effect rather than directive, its implementing rules diverge across the Member States, including issues concerning whether the stabilization of debt securities is available, when and what kind of information stabilization should disclose. Furthermore, information disclosure relating to stabilization involving more than one Member States is costly, as related information has to be published separately in line with different local rules²⁰³. A concern about these differences is raised by market participators during the Commission's public consultation, and further resolutions should be provided to secure the integrity of financial market rules.

²⁰² See contribution made by Association Française des Entreprises Privées (AFEP), and ESME Report, "Market abuse EU legal framework and its implementation by Member States: a first evaluation", p. 16, available at http://ec.europa.eu/internal_market/securities/docs/esme/mad_070706_en.pdf.

²⁰³ See contributions given by Association française des marchés financiers (AMAFI), Association of Foreign Banks in Germany, and others, available at <https://circabc.europa.eu/faces/jsp/extension/wai/navigation/container.jsp>.

The last issue concerns Accepted Market Practices (AMP). The recognition of AMP totally depends on competent authorities in each Member States, which leads to divergences in the practice. Although many parties argued that AMP should remain a national decision, custom-made according to market size, supervisory rules or other standards, it still harms the integrity of market manipulation regulation in the EU level. It's true that AMPs should be made in accordance with each market's special situations, however, it will be better to harmonize it at EU level in case of further divergence, especially when the situations in many trading markets are similar. For example, "liquidity contracts" is quasi a common circumstance that AMP is made, so a harmonisation of technical rules at EU level is a better choice.

3.1.4 Non-efficient enforcement by national regulators

Even the most delicate regulation will not be effective if lacks of sufficient enforcement. Although Market Abuse Directive has harmonized the powers of competent authorities at a certain level, substantial differences still exist among them, *"both in respect of what they can do by ways of supervision and in respect of the enforcement action, including sanctions"*.²⁰⁴ Just as the response of Borsa de Luxembourg to the Commission's public consultation regarding Market Abuse Directive reform, *"significant improvement is needed in the fights against market abuse in EU. However, regulatory or legislative action at European level will not change the current state of play in our view. Solutions have to be found at the supervisory and operational level. Enforcement action is the key in this respect."*²⁰⁵ And two main points could be concluded to explain inefficient enforcement of market manipulation regulation in the Union.

3.1.3.1 Different powers of competent authorities in the pre-investigation-phase

²⁰⁴ See De Larosière Report.

²⁰⁵ Borsa De Luxembourg, "Response from the Luxembourg Stock Exchange to the call for evidence on a review of Directive 2003/6/EC", 3 June 2009, 5193 HGD/DSE.

Pre-investigative-phase “covers actions to identify any abnormal moves on the market based on surveillance and complaints”.²⁰⁶ It is the beginning of an action against market manipulation. A national competent authority may not efficiently make a detection of suspicious market abuse if he is lack of some useful powers. Although Market Abuse Directive has made a harmonisation concerning the powers of competent authorities, not all of them enjoy the necessary resources to discover market manipulation.

Particularly, some competent authorities do not enjoy the power to have access to information of new trading platforms. The fragmentation of financial markets provides a chance for manipulators to speculate an instrument traded on regulated market through manipulating another related derivative on MTF, OTF or OTC. Taking account of the growing percentage of trading taken on them, it is reasonable for the competent authority to have access to information on these markets. However, the practical application is quite different among Member States, only some of them have full or part power concerning this information. This could be seen from Table 1, which shows the practical differences of competent authorities’ power under Market Abuse Directive for dealing with market manipulation in MTF market.

Table 1: Competent Authority’s Power under Market Abuse Directive in MTF²⁰⁷

Power under MAD in MTFs	
Full power on all MTFs	3 MSs (SP, HU, NL) + Iceland
Partial power on all MTFs	8 MSs (AT, LT, LU, NO, PO, PT, SE, SK)
Full power on some MTFs	2 MSs (EL, MT)
Partial power on some MTFs	6 MSs (BE, DE, FI, FR, IT, UK)

²⁰⁶ ESMA Report, “Actual Use of Sanctioning Power under MAD”, 26 April 2012, ESMA/2012/270, paragraph 11, p. 6

²⁰⁷ Carlos Tavares, “Opportunities for the Market Abuse Directive Revision”, p. 5, available at http://ec.europa.eu/internal_market/securities/docs/transparency/hearing20100702/tavares_en.pdf, last visited on 3 March 2015.

And Member States in this table does not include Croatia.

No power	8 MSs (BG,CY, CZ, EE, IE, LV, RO, SI) + Demark
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3.1.3.2 Some competent authorities are lack of powers in the investigative phase

Investigatory powers of competent authorities vary from Member State to Member State in practice despite improvement has been by the Market Abuse Directive, especially concerning the actual enjoyment of the power to require existing telephone and existing data traffic records. Existing telephone and existing data traffic records are among the most useful methods for national supervisors to make a successfully investigation concerning market manipulation. Given the high possibility of infringement of the privacy right when exercising this right, competent authorities, however, are required to use it with limitations, or even have right to use it.

For example, according to Dutch law, the Netherlands Authority for the Financial Markets (AFM) could not actually exercise all the powers provided in Article 12(2) of the Market Abuse Directive, including demand information from any person concerned, access to telephone and existing data traffic records, and etc.²⁰⁸ This view is also shared, more or less, by regulators in other Member States. Therefore, removing the uncertainties with regard to this power is appreciated by almost all the public authorities, according to the contributions that they provided in the 2009 consultation on the review of Market Abuse Directive.

3.1.3.3 Sanctioning powers for market manipulation diverge in the EU and are lack of deterrent effect in some Member States

Sanctioning is the last guarantee of an effective enforcement, a coherent application of which in EU-wide is critical to fight against market manipulation and then to maintain the

²⁰⁸ See “Responses of the Netherlands Authority for the Financial Markets (AFM), and on behalf of the Dutch Ministry of Finance, to the call for evidence of the European Commission’s services regarding the review of the MAD” (11 June 2009).

integrity and order functioning of the financial markets.²⁰⁹ The rules provided in the Market Abuse Directive are far from enough to realize these objectives. And deflections relating to the sanctioning powers could be discussed from three aspects.

The first aspect is concerning the incoherency actual use of administrative sanctioning powers in the EU. According to ESMA's report on the *actual use of sanctioning powers under MAD* in 2012, two competent authorities of Member States, Demark and Sweden, could not give rise to administrative sanctions neither on nature person nor on legal person when dealing with market manipulation. Even for competent authorities who are able to impose administrative sanctions, the way and conditions to use this power vary from each other. Further, the divergences among national regulators could also be revealed by the number of actual sanctions made, types of administrative measures, level of sanctions, and factors that need to be considered when sanctioning, which are generally showed in the following Table 2.

Table 2: *Differences of the actual use of administrative sanctioning power for dealing with market manipulation in Member States (except Croatia)*²¹⁰

Imposing administrative sanctions	YES	NO	
	25 MS	2 MS (Demark, Sweden)	
The number of actual sanctions made	More than 1 case	0 case	N/A
	22 MS	3 MS (Ireland, Luxembourg, Slovakia)	2 MS (Demark, Sweden)
types of	Pecuniary sanctions	Non-Pecuniary	

²⁰⁹ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press, 2014, p. 754.

²¹⁰ This table is made according to source of ESMA report on actual use of sanctioning powers under MAD in 2012, so Croatia is not included.

administrative measures	(YES)		sanctions(YES)			
	On natural person	On legal person	25 MS			
	25	24				
level of pecuniary sanctions	Minimum pecuniary sanction $\geq 10,000\text{€}$		Maximum pecuniary sanction $< 50,000\text{€}$		N/A	
	On natural person	On legal person	On natural person	On legal person	natural person	On legal person
	4 MS	5MS	7MS	1MS	2MS (Denmark, Sweden)	3MS (Denmark, Sweden, Austria)

From this table, it is not difficult to see the differences in exercising administrative power for punishing market manipulation among competent authorities in Member States. And this badly infringes the effectiveness of the EU-level market manipulation regulation, as manipulators might take advantage of the lenient sanctioning regime in a Member States.

The second aspect relates to incoherent criminal sanctions to market manipulation. Criminal sanctions usually have greater deterrent effect than administrative and civil punishment. The fear of criminal prosecution, possible imprisonment and related moral condemnation may keep potential perpetrators from carrying out market manipulation.²¹¹ Therefore, a harmonized criminal sanction regime at EU level is considered as a good way to enhance effectiveness of market manipulation regulation by the European Commission.

However, rules concerning criminal sanctions to market manipulation in Member States are quite different from each other. Currently, manipulative activities could be imposed

²¹¹ Commission staff working paper, Impact Assessment, SEC(2011) 1217 final, p. 28.

criminal sanctions in 23 Member States, while market manipulation is a criminal offence in Austria only if the same facts constitute fraud, and the remained 3 Member States, Bulgaria, Slovakia, and Slovenia, do not approve giving rise to criminal sanction.²¹² Consequently, manipulators may benefit from such regulatory difference to avoid punishment.

The last aspect is about private-law claims or civil liability. Civil compensation could be an efficient supplement to administrative and criminal sanctions based on three reasons: a) civil enforcement is brought by private parties, so there is no need for the competent authorities or other public parties to establish evidences, which will save a large number of social resources; b) the level of proof in civil case is lower than that in criminal case, therefore, manipulators would be punished at a higher chance; and c) the large compensation that needs to be paid once the private parties won the case, particularly in class actions, would enhance people's incentives to engage in such prohibited activities in the future.²¹³

Despite civil liability is accepted by more and more countries as an effective way to deter market manipulation, it is still not a common choice of all Member States in the EU. For example, a claim for damages based on a breach of the prohibition of market manipulation is denied in Germany according to the principles developed by the German Federal Supreme Court, which takes the view that market manipulation prohibition in the German Securities Act is primarily aimed at ensuring the proper functioning of the markets for securities rather than a protective law for the purposes of German Civil Code.²¹⁴ Therefore, it will be very hard to harmonise the civil sanctioning regime in the Union.

3.1.3.4 Inefficient whistleblowing regime

²¹² Ibid, pp. 59-67.

²¹³ Emiliios Avgouleas, "Market Abuse Deterrence under a Civil Liability Regime", in Emiliios Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*, pp. 449-470.

²¹⁴ Freshfields Bruckhaus Deringer, "European Market Abuse News", Winter 2012, p. 3.

Inefficient whistle-blower regime²¹⁵ reduces the clear-up rate for market manipulation. Whistleblowers, usually the company insiders, may come across evidence of market manipulation during their daily works, so they probably can find some evidences which are hard to detect from outside and save more resources when collecting information.²¹⁶ Whistleblower tips are becoming almost the most efficient way to combat market manipulation or financial fraud in these days. It contributes to 54.1% of the detection of uncovered fraud schemes in the listed corporations in the USA and this number is about 6 times to that detected by external auditors and the SEC exam team together.²¹⁷ Although it is also considered to be very useful and helpful by competent authorities in Member States in the EU²¹⁸, the whistleblowing case number is very low in EU.

Despite the market structure and culture differences, this is partially caused by insufficient protections and incentives for the potential whistle-blowers. The regime on the basis of Market Abuse Directive and its implementing Directive 2004/72/EC focuses on the notification obligation of a whistle-blower and the main contents of the notification, while protection of the whistleblower from retaliation is only a generally provision. Such arrangement will significantly undermine related a person's motivation to report suspicious transactions, as they may face discrimination or loss of jobs if their notification is discovered.

Besides, current whistleblowing regime in the Union is not applicable to OTC derivatives. Given the big influence and complexity of derivatives, whistleblowing could play a more important role in the prevention of market manipulation in the related markets. Consequently, improving the whistle-blower regime is going to be an efficient and

²¹⁵ Whistle-blower regime is usually mentioned as Suspicious Transition Report, and it means that a diverse range of participants often employed alerts suspicious transactions.

²¹⁶ Holger Fleischer, "Whistleblower Bounties in European Capital Markets Law?" (2012) 9 *European Company Law*, Issue 4, pp. 200–200.

²¹⁷ S. Rep. No. 111-176, 110-11 (2010), Section 922. Besides, to improve the rights of whistle-blowers is one of the most important points in the recent American Dodd Frank Act.

²¹⁸ The third set of CESR guidance and information on the common operation of the Directive to the market, Reference CESR/09-219, p.8.

economical way to help national supervisors to detect manipulation cases in the financial market.

3.2. Structure Reform: from Directive to Regulation

The current market manipulation regulation is mainly based on EU directives, which need Member States' transposition to be applicable. Because of the discretion, the actual market manipulation regime in Member States is quite different from each other. Therefore, a structure reform is made by the EU legislators.

After the reform, the Market Abuse Regulation will totally take place of Market Abuse Directive and its implementing directives, which means that the main legislative act for regulating market manipulation will be a regulation rather than a directive. As an EU regulation, Market Abuse Regulation has a direct effect in all Member States,²¹⁹ the implementation of which does not further enactment of domestic legislation. Member states, however, will need to amend or repeal the provisions in their national law with regard to market manipulation regime in order to reflect the creation of the new directly applicable rules.²²⁰

As a level 1 legal framework of the Lamfalussy four-level procedure, most of the key areas of the Market Abuse Regulation are to be supplemented by detailed technical standards to be prepared by ESMA for approval by the Commission. These second level acts will provide detailed requirements that market participants and advisors need to comply with. *“The full impact of the new regime, and the compliance procedures that will need to be put in place, will therefore not be clear until these technical standards have been finalised.”*²²¹

²¹⁹ Treaty on the Functioning of the European Union, Article 288(2): “A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.”, Official Journal C 115, 9 May 2008, pp. 47-199(TFEU).

²²⁰ Carol Shutkever, Karen Anderson, Jenny Stainsby and Mike Flockhart, “Special Report: The EU’s New Market Abuse Regime”, *World Securities Law Report*, August 19, 2014.

²²¹ Ibid.

The structure change, from a directive to a regulation, seeks to create a single and directly applicable rulebook of EU market manipulation, reduce the divergences that arise from the transposition of a Union Directive to national legislations, and provide more legal certainty and less regulatory complexity for market participants, especially for participants performing cross-border activities.²²²

Furthermore, a new Directive on criminal sanctions for insider dealing and market manipulation is also adopted by the EU. It is a complement to Market Abuse Regulation by introducing minimum rules on criminal offences and criminal sanctions for market manipulation. Member States have the option to retain or adopt more stringent criminal law provisions. Except from Denmark and the UK, other Member States will need to transpose this Directive into their national legislations.

3.3. Substantial reform: expansion of the scope of market manipulation regime in terms of trading venues and products

In the last decade, investment instruments have increasingly traded on non-regulated markets, and new types of financial products have attracted more and more investors. However, the lenient rules concerning these new trading platforms and investment instruments provide a good opportunity for manipulators. Therefore, Market Abuse Regulation greatly expands the scope of market manipulation regime to deal with this situation compared with that provided in Market Abuse Directive.

3.3.1. Expansion of trading venues subject to the market manipulation regime

According to Market Abuse Regulation, the new market manipulation regime will apply to trading on all European Economic Area (EEA for short) trading facilities, including regulated markets, multilateral trading facilities (MTFs), organized trading facilities

²²² See Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) (Market Abuse Regulation), COM/2011/0651 final, Preamble 4 and 5.

(OTFs²²³),²²⁴ whereas the current regime applies only to trading on a regulated market within EU²²⁵. This change means an end to the divergences in the application of market manipulation rules concerning MTF or OTF in Member States, as well as the situation that competent authorities is lack of supervisory power on MTF or OTF as those showed in Table 1.

Besides, an OTC may also be covered by the market manipulation regime if the price or value of a financial instrument traded on a regulated market, on a MTF or on an OTF, depends on or has an effect on the price or value of an instrument traded on the OTC.²²⁶

Furthermore, a commodity market may also fall into the market manipulation prohibition according to Market Abuse Regulation. Market manipulation regulation does not intend to govern directly the commodity market, which is identical with the majority opinion contributed during the call for evidence for the review of Market Abuse Directive.²²⁷

However, the regime applies if transactions, orders to trade or other behaviour relating to spot commodity contracts has or is likely or intended to have an effect on a financial instrument covered by the Regulation.²²⁸

This new amendment is an appropriate way to make up the regulatory loophole in commodities and related derivatives markets. But certain concerns are raised after this change, such as, the allocation of allocation of supervisory responsibilities between ESMA and the Agency for the Cooperation of Energy Regulators (ACER)²²⁹, or the

²²³ “*Organised trading facility or ‘OTF’ means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of this Directive.*” Directive 2014/65/EU on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Article 4(1)(23).

²²⁴ Market Abuse Regulation, Article 2(1)(a),(b) and (c).

²²⁵ Market Abuse Directive, Article 9, paragraph 1.

²²⁶ Market Abuse Regulation, Article 2(1)(d).

²²⁷ Contributions from all parties are available at

<https://circabc.europa.eu/faces/jsp/extension/wai/navigation/container.jsp>, last visited on 3 March 2015.

²²⁸ Market Abuse Regulation, Article 2(2)(a).

²²⁹ The Agency for the Cooperation of Energy Regulators (ACER), a European Union Agency, was created by the Third Energy Package to further progress on the completion of the internal energy market both for electricity and for natural gas. For further details, see

http://www.acer.europa.eu/The_agency/Pages/default.aspx, last visited on 5 March 2015.

possibility that market participants may be subject to multiple and differing obligations as to conduct and information supply, and multiple investigations with different possible consequences.²³⁰

3.3.2 Expansion of products subject to the market manipulation regime

Compared with Market Abuse Directive, the new Regulation will make significant improvement concerning the scope of market manipulation regime in terms of products. On the one hand, Market Abuse Regulation unifies the meaning of “financial instrument” in Market Abuse Regulation and in MiFIR²³¹, which mitigates the confusion for financial market participants. On the other hand, the prohibition of market manipulation is extended to transactions, orders to trade or other behaviour relating to new types of financial instrument, spot commodity contracts and benchmarks.²³²

3.3.2.1 Special types of financial instruments

Some types of financial instruments, in particular derivative contracts or derivative instruments for the transfer of credit risk (hereinafter referred as credit derivatives), the transaction, order or behaviour of which has or is likely or intended to have an effect on spot commodity contracts or on a financial instrument traded on regulated market, on MTF, or OTF.²³³ Market Abuse Regulation catches the manipulation perpetrated by speculating derivatives on OTC or by manipulating contracts on spot commodity market, in order to fill the loophole in Market Abuse Directive because of the development of multi-level financial markets.

3.3.2.2 Spot commodity contracts

²³⁰ John Ratliff and Roberto Grasso, REMIT - EU Legislation on Insider Trading and Market Manipulation in Wholesale EU Energy Markets Adopted, available at <http://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=87107>, last visited on 5 March 2015.

²³¹ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012

²³² Market Abuse Regulation, Article 2(2).

²³³ Ibid, Article 2(2)(b).

Spot commodity contracts, which are not wholesale energy products, may also be covered by the new market manipulation regime, if the transaction, order or behaviour of such contracts has or is likely or intended have an effect on a financial instrument that traded on a regulated market, on MTF, or on OTF.²³⁴ Considering the high interconnection between commodity markets and related derivative markets, cross-market manipulation may take place by transactions in the spot market which is used to manipulate derivatives markets, or vice versa.²³⁵ The regulatory gap concerning this situation is filled by Market Abuse Regulation.

3.3.2.3 Benchmarks

Benchmark is “*any commercial index or published figure calculated by the application of a formula to the value of one or more underlying assets or to prices by reference to which the amount payable under a financial instrument is determined*”²³⁶. Benchmark indexes are used widely as a reference rate for the pricing of many financial instruments, such as interest rate swaps. Therefore, manipulation of benchmark would cause a serious impact on market confidence, make big damage to investors, and seriously distort the real economy distortion.²³⁷

Since the Libor (the London inter-bank offered rate) and Euribor (The Euro Interbank Offered Rate) scandals²³⁸ break out in 2011, benchmark manipulation raised a worldwide concern. However, this type of manipulation is neither covered in Market Abuse Directive or in the proposal adopted in October 2011, so an immediate amendment was made in

²³⁴ Market Abuse Regulation, Article 3(2)(a).

²³⁵ Ibid, Recital 20.

²³⁶ MiFIR, Article 2(1)(24).

²³⁷ Amended proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse), COM(2012) 421 final, p. 2.

²³⁸ The Libor and Euribor scandal included a series of fraudulent actions concerning the Libor and Euribor as well as the resulting investigation and reaction. The Libor is an average interest rate calculated through submissions of interest rates by major banks in London and it is also an important index for derivatives, which underpins about \$350 trillion in derivatives. The Libor scandal happened when it is reported that some banks were falsely inflating or deflating their rates so as to profit from trades, or to give the impression that they were more creditworthy than they were. Eight banking giants, Barclays, Deutsche Bank, Soci   G  n  rale, RBS, UBS, JPMorgan, Citigroup and RP Martin, have been fined a combined total of  1.71bn by the European Commission for rigging the key benchmark interest rates Libor and Euribor.

order to add benchmark manipulation into market manipulation prohibition.²³⁹ It is now provided in the Market Abuse Regulation that, any manipulative behaviour in relation to benchmark will be prohibited.²⁴⁰ Further, manipulation of benchmark will be subject to criminal sanction if it is serious and perpetrated with intent.

3.3.2.4 Emission allowances

According to the reclassification of “financial instrument” made in MiFIR, emission allowances is a type of financial instrument, which will be covered by the new market manipulation regime. It is forbidden to buy or sell on secondary market of emission allowances or related derivatives prior to the legal auction with the effect of fixing the auction clearing price for the auctioned products at an abnormal or artificial level or misleading bidders bidding in the auctions.²⁴¹

3.4. Substantial Reform: Refined definition, new prohibition and detailed derogations

3.4.1 A refined definition of market manipulation

Market Abuse Regulation, like the Market Abuse Directive, adopts the effects-based approach, defining market manipulation in terms of trading practices (Article 12(1)(a) and (b)) and dissemination of false or misleading information (Article 12(1)(c)).²⁴² However, improvements have been made concerning its supportive rules.

In order to build market understanding of market manipulation, Market Abuse Regulation brings most of the indicators, signals and examples of possible market manipulation, which are provided in the amplified directives of Market Abuse Directive

²³⁹ Amended proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse), COM(2012) 421 final.

²⁴⁰ Market Abuse Regulation, Article 2(2)(c).

²⁴¹ Ibid, Article 12(2)(e)

²⁴² Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press, 2014, p. 741.

and CESR guidance, into the Regulation and its Annex. This change could ensure the definition of market manipulation highly detailed and directly applicable.

Market manipulation defined in the Market Abuse Regulation, except from the three sub-definitions, is supported by Article 12(2), which sets out the types of behaviour that will be considered as market manipulation, including abusive squeezes²⁴³, marking the opening or close²⁴⁴, manipulation concerning algorithmic and high frequency trading²⁴⁵, information-based abuse (taking advantage of occasional or regular access to the traditional or electronic media)²⁴⁶, and specific behaviours in the emission allowance market²⁴⁷. Further, this definition is also supported by the non-exhausted list of indicators provided in Annex 1 of Market Abuse Regulation. Indicators concerned generally map the rules in CESR guidance, which should not be considered as market manipulation unless there are no legitimate reasons.

In general, Market Abuse Regulation refines the definition of market manipulation by bring much of the administrative rulebook into the Regulation, which reduce regulatory divergence and ensure a clear and directly binding legal regime.²⁴⁸

3.4.2 An additional prohibition of market manipulation

It is commonly accepted that manipulative behaviours are always difficult to prove. Although the adoption of effect-based approach for defining market manipulation has reduced the regulator's burden of proof regarding the mental element, there still are situations where the actual effect on the market has not been achieved perpetrators, which is uneasy to be determined as manipulation. For this reason, an expressly prohibition of attempted market manipulation would be a helpful way to enhance the enforcement of market manipulation prohibition. In particular, attempted market manipulation will be

²⁴³ Market Abuse Regulation, Article 12(2)(a)

²⁴⁴ Ibid, Article 12(2)(b)

²⁴⁵ Ibid, Article 12(2)(c)

²⁴⁶ Ibid, Article 12(2)(d)

²⁴⁷ Ibid, Article 12(2)(e)

²⁴⁸ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press, 2014, p. 741.

useful for supervisors of commodity markets, where enforcement action is not easy to bring because of multi reasons for price movements.

Attempted market manipulation is a strong deterrent of market offence. However, in order to avoid punishing behaviours that have no concrete or potential aptitude to rig financial instruments' price, attempted market manipulation should be delicately defined, as unlawful attempts and legal businesses of intermediaries are usually indistinguishably in practice.²⁴⁹

According to Article 12 and 15 as well as recital 46 and 47 of Market Abuse Regulation, an attempt to engage in market manipulation may comprise (a) attempting to enter into a transaction, trying to place an order to trade or trying to engage in any other trade-based manipulative behaviour, and (b) attempting to disseminate information as defined in information-based manipulation.

Unfortunately, this definition is not well defined. Firstly, the general prohibition of “attempting to enter into a transaction” and “trying to place an order” probably include any trader in the capital market, which would be useless in practice. Second, *mens rea* element should be clearly provided. As the obscure border between legal commercial activities and manipulative practices, it is necessary to give a relatively high threshold of intention to guarantee a secured regulatory environment for market participants.

Furthermore, there seems is a contradiction in the current regime. As the trade-based market manipulation provided in Article 8(1)(a) is effect-based not intent-based, while the judgment of an attempted based-trade manipulation will unavoidable to evaluate the intention, so it is just like what Association française des marchés financiers (AMAFI) claimed that “*There is no such thing as an attempt at market manipulation but only actual*

²⁴⁹ See contributions provided by Association française des marchés financiers (AMAFI), Associazione Italiana Intermediari Mobiliari (ASSOSIM) for the 2010 public consultation on the review of the market abuse directive hold by the European Commission, available at http://ec.europa.eu/internal_market/consultations/2010/mad_en.htm, last visited on 5 March 2015.

manipulations. The challenge is to move away from the criterion of impact on the price to other criteria that regulators could use to qualify the abuse.”²⁵⁰

Attempted market manipulation actually is a supplement to market manipulation, aiming to catch manipulative behaviours that could not be proved by the regulators with the latter’s strict criteria. Yet, what could be a suitable definition for attempted market manipulation? It would be appropriate for regulators to take actions when they could not prove or hard to prove that a person has caused an artificial or abnormal price of a financial instrument, while it can be proven that a person (a) has had an intention to manipulate, (b) has executed transactions, place orders, or disseminating false or misleading information and, (c) has had an impact on the price.²⁵¹

3.4.3 Increasing legal certainty of derogations to market manipulation

Derogations afford defences to behaviours that would otherwise amount to market manipulation. In terms of safe harbours, buy-back programmes and stabilization, Market Abuse Regulation repeals Commission Regulation 2273/2003 and maps its major rules. A harmonisation concerning this regime will be made through regulatory technical standards developed by ESMA, which will specify the conditions that buy-back programmes and stabilization measures must meet, including conditions for trading, restrictions regarding time and volume, disclosure and reporting obligations, and price condition.²⁵²

The significant change made in this section is with regard to Accepted Market Practices (AMPs). Divergent AMPs are considered as a main reason for creating legal uncertainty

²⁵⁰ Association française des marchés financiers (AMAFI), Response of the AMAFI to the European Commission’s public consultation on a revision of the Market Abuse Directive, available at https://circabc.europa.eu/faces/jsp/extension/wai/navigation/container.jsp?FormPrincipal:_idcl=FormPrincipal:_id3&FormPrincipal_SUBMIT=1&id=0432ee60-597f-4ba8-91c9-7423b4a124dd&javax.faces.ViewState=rO0ABXVyABNbtGphdmEubGFuZy5PYmplY3Q7kM5YnxBzKWwCAAB4cAAAAAN0AAExcHQAKy9qc3AvZXh0ZW5zaW9uL3dhaS9uYXZpZ2F0aW9uL2NvbnRhaW5lci5qc3A.

²⁵¹ Mathias Siems and Mattijs Nelemans, “The Reform of the EU Market Abuse Law: Revolution or Evolution”, the *Maastricht Journal of European and Comparative Law*, vol 19 (2012), pp 195-205.

²⁵² Some refinements can be expected through the initial policy orientation of ESMA. See ESMA, “Discussion Paper ESMA’s policy orientations on possible implementing measures under the Market Abuse Regulation”, ESMA 2013/1649, pp. 8-17.

of market manipulation regime. Although the Commission failed to remove the AMP regime out of the new regulation, this regime has been significantly recast, primarily by means of the incorporation of the original Market Abuse Directive AMP administrative regime within Market Abuse Regulation and the conferral of a range of oversight powers on ESMA.²⁵³ Compared with the current market manipulation regime, Member States will be subject to stricter scrutiny when establishing an AMP in their markets and further will have to follow technical standards drafted by ESMA.²⁵⁴

National Competent authorities will have to, not less than three months before the AMP is intended to take effect, notify ESMA and other regulators of their intention to establish an AMP, and provide details of their assessment of the criteria which must be examined.²⁵⁵ Then ESMA will provide and publish an opinion concerning the compatibility of the notifying AMP with criteria provided and related regulatory technical standards. Meanwhile, whether the proposed AMP would threaten the market confidence in the EU financial market should be assessed in the opinion.²⁵⁶ Further, ESMA shall publish a list of AMPs, monitor their application and submit an annual report concerned to the Commission.²⁵⁷ And finally, a competent authority can challenge AMP in another with the help of ESMA and, in any event, he should review his AMPs at least every two years.²⁵⁸

Conclusion of Chapter 3

Although Market Abuse Directive greatly refines the market manipulation regime at the EU level, a number of defections and regulatory gaps have been revealed in practice. Benefiting from post-FSAP commitment to Better Regulation, European Commission

²⁵³ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, p. 751.

²⁵⁴ Market Abuse Regulation, Article 13(7).

²⁵⁵ Market Abuse Regulation, Article 13(3)

²⁵⁶ Market Abuse Regulation, Article 13(4)

²⁵⁷ Market Abuse Regulation, Article 13(9) and (10).

²⁵⁸ Market Abuse Regulation, Article 13(6) and (8).

committed to review the implementation and functioning of the Directive at the end of 2007.

The review of Market Abuse Directive soon became incorporated within the wider crisis-era reform programme.²⁵⁹ According to contributions collected from public consultations and expert reports, the major weaknesses of current market manipulation regime have been identified, which include regulatory gaps in the terms of trading venues and of financial instruments, notably market manipulation in commodity derivatives and related spot markets; legal uncertainty caused by AMPs; inefficient enforcement linked to limited national competent authority powers and cooperation system among EU securities regulators; and regulatory arbitrage as a result of sanctioning divergences.²⁶⁰

With the adoption of Market Abuse Regulation and Directive on criminal sanctions for market abuse, the regulatory package will repeal Market Abuse Directive and its related supporting administrative rules. Market manipulation regime will be further harmonised at the EU level. On the one hand, a structure reform is made. Regulation will replace directive to be the cornerstone of market manipulation regulation, which would ensure a higher definite and directly binding legislative system, and significantly reduce divergences during enforcement of Member States.

On the other hand, substantial reform has also been made to efficiently prevent market manipulation in the EU financial markets. The first part of substantial reform is concerning scope, definition and exceptions of market manipulation regime, while the second part focuses on supervision and enforcement, which is analysed in detail in Chapter 4.

Market manipulation regime after the reform, will expand beyond an original prohibition on a range of manipulative behaviours, extending the regime to include manipulation

²⁵⁹ Niamh Moloney, *EU Securities and Financial Markets Regulation*, p. 710.

²⁶⁰ Niamh Moloney, *EU Securities and Financial Markets Regulation*, p. 710.

relate to commodity derivatives, HFT, emission allowance, and benchmarks. The wider scope of market manipulation regulation aims to provide effective prevention of market manipulation that take place cross boarder or cross markets.

Besides, market manipulation will be better defined by that Market Abuse Regulation bring indicators, signals and typical examples of market manipulation, which are currently provide in supporting administrative rules of Market Abuse Directive, into the Regulation and its Annex. Meanwhile, attempted market manipulation is added as a new prohibition, in order to catch behaviours that do not successfully achieve the effect of speculating the price, the supply or demand of an instrument. Further, the AMP regime will be under strict scrutiny of ESMA to reduce divergences among Member States.

Chapter 4 Reform of the EU Market Manipulation Regime: Part (2) supervision and enforcement

Destructive imbalance in the regulatory and supervisory architecture was considered as the core issue in the EU crisis, given “the specific and additional difficulties arising from the mis-match between the pan-EU operations of some major banking groups and nationally-based supervision and resolution regimes”.²⁶¹ Market Abuse Regulation is trying to enhance the effectiveness of supervision and enforcement through increasing the investigatory and supervisory powers of competent authorities, refining the coordination, cooperation and information-sharing system among competent authorities, and harmonising sanctioning regimes of market manipulation in the EU.

4.1 Increasing the investigatory and supervisory powers of competent authorities

Investigatory and supervisory powers are important tools for competent authorities to guarantee supervisory effectiveness. Given that the actual powers exercised by national competent authorities vary greatly, a set of changes has been made to ensure them in possession of adequate tools and powers.

4.1.1. Strengthening the existing powers enjoyed by competent authorities

The power significantly improved is the right to require existing telephone and existing data traffic data records. The importance of telephone and data traffic records for detecting market manipulation is without debate, the rule provided in Market Abuse Directive, however, is too general and ambiguous, which lead to a lack of legal certainty. As a consequence, not all regulators in Member States could actually enjoy this power in the practice. For example, the Dutch law on telecommunication restricts the power of the AFM to require existing telephone and existing data traffic records.²⁶² So it is generally

²⁶¹ Niamh Moloney, “EU financial market regulation after the global financial crisis: ‘more Europe’ or more risks?”, *Common Market Law Review* 47: 1317-1389, 2010, p.1319.

²⁶² See Netherlands Authority for the Financial Markets (AFM), “Responses of the Netherlands Authority for the Financial Markets (AFM), and on behalf of the Dutch Ministry of Finance, to the call for evidence of the European Commission’s services regarding the review of the MAD”, 11 June 2009, p.5.

supported by the European Commission and all the competent authorities that, the new market manipulation regulation will contain a clear statement that the power to acquire telephone and data traffic records should be granted to national competent authorities and should not be constrained by confidentiality restraints or other limitations.²⁶³

Therefore, Market Abuse Regulation not only confirms the record requiring power of competent authorities, but also sets out clear conditions for its exercises. Firstly, Member States shall ensure that competent authorities, on the one hand, have the right to acquire existing recordings of telephone conversations, electronic communications or data traffic records held by investment firms, credit institutions or financial institutions; and on the other hand, have the power to require existing data traffic records held by a telecommunications operator in conformity with national law. Secondly, a reasonable suspicion of an infringement of market manipulation must exist to use this power. And thirdly, records required must be relevant to the investigation of the manipulative infringement.²⁶⁴ Besides, all the records required shall be telephone and data traffic that already exists. Information provider does not have the obligation to prepare new records, and the information provided shall not concern the content of communication.

Compared with the prior rule provided in Article 12(d) of Market Abuse Directive, the new regulation makes a great process to eliminate the uncertainties on the rights of the competent authorities to have access to records. It clearly states that what kind of records could be required, from who the records could be got, and what conditions should be satisfied. Nevertheless, new confusion is at the same time created by the “reasonable suspicion” which is a key element when requiring data traffic records from telecommunication operators. Since there is no uniform definition of “reasonable

²⁶³ Netherlands Authority for the Financial Markets (AFM), “Responses of the Netherlands Authority for the Financial Markets (AFM), and on behalf of the Dutch Ministry of Finance, to the call for evidence of the European Commission’s services regarding the review of the MAD”, 11 June 2009, p.5. Also see European Commission, “Call for Evidence – Review of Directive 2006/6/EC on Insider Dealing and Market Manipulation (Market Abuse Directive)”, April 200, pp. 14-15.

²⁶⁴ Market Abuse Regulation, Article 23(2)(g) and (h).

suspicion” in the Regulation or relating legislation, it will result in discretionary enforcement in Member States.

Another improvement is made concerning the on-site inspections. According to Article 23(2)(d) of the Market Abuse Regulation, national competent authority has the right to carry out on-site inspections. But an exception is added: on-site inspections and investigations should be carried out at sites other than at the private residences of natural persons, and it should lessen the possibility of infringing the right to private privacy.

4.1.2 New supervisory and investigatory powers conferred to the national competent authorities

4.1.2.1 The power to have access to information of spot commodity markets

Market manipulation can take place across spot and derivatives markets. *“Trading in financial instruments, including commodity derivatives, can be used to manipulate related spot commodity contracts and spot commodity contracts can be used to manipulate related financial instruments”*.²⁶⁵ However, information in the spot markets is not as transparent as that in the securities market, because spot markets are not subject to the transparent rules followed in the financial market. Hence, it is necessary for competent authorities to have information regarding related spot market in order to have a better detection of such kind of market manipulation.

After the reform made by the Market Abuse Regulation, competent authority, in relation to derivatives on commodities, can request information from market participants on related spot markets according to standardized formats, obtain reports on transactions, and have direct access to traders’ system.²⁶⁶ Gaining information from market participants provides more opportunities for competent authorities to detect and investigate suspicious market manipulative activities; and having direct access to traders’ system enable supervisors monitor real-time data flows in physical markets in the circumstance that information may

²⁶⁵ Market Abuse Regulation, Preamble 20.

²⁶⁶ Market Abuse Regulation, Article 23(2)(c).

be insufficient in particular if no sectoral authority to supervise those spot commodity markets exist.²⁶⁷

4.1.2.2 Power to enter private premises to seize documents and data

In some special cases competent authorities might face the risk to be deprived from important and necessary evidence, and accordingly, lose the chance to detect or even sanction cases of market manipulation. These situations include the circumstance where a person fails wholly or in part to comply with the authority's demand for information, or where "*there are reasonable ground for believing that if a demand were to be made, it would not complied with, or that documents or information to which the information requirement relates, would be removed, tampered with or delayed*".²⁶⁸ In order to avoid such circumstances, the new regulation allows supervisors to enter private premises to seize evidences as soon as possible.

For exercising the power to enter private premises to seize documents and data, competent authorities must satisfy the following conditions. Firstly, there should be a reasonable suspicion that documents or data in any form relating to the subject matter of the inspection or investigation may be relevant to prove a case of market manipulation.²⁶⁹ Secondly, national law regarding entering private premises must be followed, and a prior authorization should be obtained from the judicial authority if required. However, the same issue about the definition of "reasonable suspicion" exists, which is similar with that in the power to have access to telephone conversation and data traffic records.

4.1.2.3 Power to refer matters for criminal investigation

Competent authorities will be empowered to refer manipulative offences for criminal investigation. Criminal sanctions of market manipulation currently are not available in all the Member States. Some competent authorities, such as Financial Supervision

²⁶⁷ Proposal of the Market Abuse Regulation, p. 11.

²⁶⁸ Market Abuse Regulation, Preamble 64.

²⁶⁹ Market Abuse Regulation, Article 17(2)(e).

Commission (Bulgaria) and Hungarian Financial Supervisory Authority (Hungary), only can make or refer for administrative investigation.²⁷⁰ With the harmonization of criminal sanction made in the new market abuse regulation package, criminal sanctions should be available to manipulative offences in the EU. Therefore, it is necessary for competent to have the right refer market manipulation cases for criminal investigation.

In general, increasing the supervisory and investigatory powers of competent authorities is a good way to increase the possibility to detect and sanction of cross-border or cross-market manipulative behaviours. Market Abuse Regulation will greatly enhance the efficiency of supervision and enforcement of market manipulation taking consideration of improvement made in this aspect. Even though these changes are commonly welcomed by the public, they are not totally out of debate.

Some market participants argued that the powers of supervisory authorities provided in the Market Abuse Directive to investigate market manipulation are adequate. The way to solve enforcement problem does not lie in increasing powers but in ensuring that the existing powers are consistently implemented by all Member States.²⁷¹ And further concern is brought by most market participants with regard to certain aggressive powers of the competent authorities, such as entering the private premises to seize documents, requiring existing recordings of telephone conversations, electronic communications or data traffic record, because these powers dramatically increase the obligation for the private parties to provide information and the possibilities of interference of fundamental rights. Issues relating to market manipulation and fundamental rights will be further analysed in following part.

²⁷⁰ European Securities and Market Authority, “Report: Actual use of sanctioning powers under MAD”, ESMA/2012/270, 26 April 2012, p. 27.

²⁷¹ See the Central Chamber of Commerce of Finland, “Consultation on a Revision of the Market Abuse Directive”, 16 July, 2010, p. 2; Confederation of Finnish Industries EK, “Response to European Commission Public Consultation on the Review of the Market Abuse Directive (MAD)”, 23 July, 2010, p. 3; and Alternative Investment Management Association, “Response to European Commission Public Consultation on the Review of the Market Abuse Directive (MAD)”, 23 July 2010, p.7.

4.2 A refined supervisory cooperation mechanism

Coordination and organization of supervision across the internal financial market is at the centre of the EU financial supervision. Although Market Abuse Directive has established a framework to strengthen cooperation between national regulators, the global financial crisis and the following European debt crisis have revealed numerous weaknesses with regard to the supervision of cross-border activities in the financial market. And the EU coordination system of regulators is also proved to be inefficient.²⁷² Further, the 3L3 committees of local supervisors²⁷³ are ill-equipped to deal with crisis management and coordination.²⁷⁴ For example, CESR failed to coordinate on the issue concerning the prohibition of short selling in Member States.²⁷⁵ As a result, reform of market manipulation regime focuses on strengthening supervisory cooperation.

A refined supervisory cooperation mechanism is developed in the Market Abuse Regulation, in particular with the establishment of ESMA, a successor of CESR. The new cooperation mechanism is constituted by two main elements: information sharing system and cooperation of investigation, supervision and enforcement.

4.2.1 A more efficient information-sharing system

Competent authorities in Member States are required to exchange information with each other, and with ESMA as well as third national supervisor. Such information-sharing obligation is a key part of the EU cooperation mechanism of supervisors. Compared with rules provided in Market Abuse Directive, system of information exchange after the reform will work more efficiently.

²⁷² See Duncan Alford, "Supervisory Colleges: The Global Financial Crisis and Improving International Supervisory Coordination" (2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1545291. And also see The de Larosi ère Report, paragraph 159.

²⁷³ They are constituted by CESR (securities markets), CEBS (banking), and CEIOPS (insurance and occupational pensions).

²⁷⁴ Niamh Moloney, "EU financial market regulation after the global financial crisis: 'more Europe' or more risks?", *Common Market Law Review* 47: 1317-1389, 2010, pp. 1364-1365.

²⁷⁵ German unilateral banned naked short selling without first informing their other European Union counterparts in 2010. See Nikki Tait, Peggy Hollinger in Paris, and Brooke Masters in London "EU talks over German short-selling ban", May 24, 2010, Financial Times.

Firstly, the new information-sharing system will include more types of information. Information that could be required by competent authorities will not be limited to information concerning investment instruments' trading or orders to trade in the financial market. It will also cover information relating to commodities which are agricultural products listed in Annex I to the TFEU, information concerning energy market, trading information of wholesale energy products and emission allowances, and information in the related spot markets.²⁷⁶ Having access to these types of information will facilitate competent authorities' detection of cross-border and cross-markets manipulative activities.

Secondly, more institutions and bodies are involved in the cooperation system of information exchange. Not only national competent authorities to cooperate with each other and to cooperate with ESMA, other institutions and bodies are also required to provide information to ESMA, which include EU supervisory authorities (e.g. the Agency for the Cooperation of Energy Regulators (ACER)), the national minister responsible for finance, national central banks, statistical office of the Member State concerned if the national competent authorities fail, or even directly to financial market participants if the former two ways do not work out.²⁷⁷ This amendment ensures that competent authorities and ESMA can timely obtain necessary information to investigate or supervise market manipulation in the financial market.

And thirdly, new reason concerning the refusal of information exchange and investigation cooperation has been added. Following the new rule, a competent authority could refuse to provide information in a new circumstance, where "*complying with the request is likely adversely to affect its own investigation, enforcement activities or, where applicable, a criminal investigation*".²⁷⁸ However, this change is quite arguable. According to the

²⁷⁶ Market Abuse Regulation, Article 25.

²⁷⁷ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 on establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (hereinafter Regulation 1095/2010), Article 35.

²⁷⁸ Market Abuse Regulation, Article 25(2)(b).

opinion of the European Commission and the Germany regulator, competent authorities should have a narrow scope of reasons to refuse information-sharing in order to guarantee an efficient cooperation with other competent authorities.²⁷⁹ While regulators in other Member States claimed that reasons for refusal of requiring information provided in Market Abuse Directive are adequate and there is no need to change.²⁸⁰ Despite these arguments, Market Abuse Regulation, on the contrary to reducing reasons, adds a new reason for refusal. It is reasonable to state that this addition is made because the new cooperation system will cover a much wider scope than before, so some refusals of information requirement should be allowed in case of abuse of information by competent authorities.

Nonetheless, although the benefits of these changes made concerning information-sharing system are obvious, there still is a point that deserves further consideration. According to Article 25(4) of Market Abuse Regulation, the requested party should provide the information immediately, when a request for providing information is made by a competent authority. This rule is, however, not suitable, considering the fact that supplying information on an “immediate” basis is not always practical or logistically possible.²⁸¹ So a “timely” basis seems more proper.²⁸²

4.2.2 Cooperation for cross-border investigation

With regard to the cross-border investigatory cooperation between competent authorities, Market Abuse Regulation enlarges the scope of activities that could be done by national regulators. And the biggest change is regarding with the permissible actions of the requesting competent authority in the territory of the requested Member State.

²⁷⁹ See European Commission, “Public consultation on a revision of the Market Abuse Directive (MAD)”, 2010, p. 11; and Federal Ministry of Finance (Germany), “Response to the European Commission’s Review of Directive 2003/6/EC on insider dealing and market manipulation (Market Abuse Directive)”, 2010.

²⁸⁰ See Joint FSA/HMT response to European Commission Public Consultation (dated 25.06.2010) on A Revision of the Market Abuse Directive (MAD) and the Czech National Bank’s opinion for Consultation Document of the European Commission revision of the Market Abuse Directive.

²⁸¹ Joint FSA/HMT response to European Commission Public Consultation on A Revision of the Market Abuse Directive (MAD), (dated 25.06.2010), p. 11.

²⁸² “Timely” is used in several provisions in the Market Abuse Regulation, such as Article 13 and 17.

Under Market Abuse Directive, cross-border investigation was subject to the overall control of the host Member States, and the requesting authority could only ask that its personnel could be allowed to accompany the requested regulator's personnel during investigation.²⁸³ However, according to the new regulation, the requesting authorities are not limited to accompany situation, they could, if the requested authority agrees, participate in the on-site inspection or investigation or carry out the on-site inspection or investigation by itself. Nevertheless, some authority argued that the investigation of market manipulation should remain to be taken by the requested national supervisor, as it is more familiar with the national legal and policy considerations affecting investigations.²⁸⁴

In addition to rights of requesting competent authority, the requested one will have an additional choice of appointing auditors or experts to carry out the on-site inspection or investigation, of sharing specific tasks related to supervisory activities with the other competent authorities, or of cooperating with competent authorities of other Member States with respect to facilitating the recovery of pecuniary sanctions.²⁸⁵

4.2.3 ESMA's critical role in the new cooperation system

It is one of the most important areas in the reform of market manipulation regime that ESMA will play an active role in facilitating and ensuring a strong coordination. In response to the global financial crisis, the European Union made a financial supervisory system reform according to the advice in De Larosi ère report²⁸⁶. ESMA, as one of the three supervisory authorities established in the European System of Financial Supervision (ESFS), is responsible for the supervision in the securities market.²⁸⁷ This new authority not just takes the place of its forerunner CESR, but has been granted powers “more powers

²⁸³ Niamh Moloney, *EC Securities Regulation*, Oxford University Press, the second edition (2008), p. 996.

²⁸⁴ Niamh Moloney, *EC Securities Regulation*, p. 996.

²⁸⁵ Market Abuse Regulation, Article 25(6).

²⁸⁶ The de Larosi ère Report.

²⁸⁷ The other two authorities are European Banking Authority (EBA), which supervises the bank industry, and European Insurance and Occupational Pensions Authority (EIOPA), which is in charge of the insurance and occupational pension area.

than has typically been the case for the other independent European agencies that have been set up at the EU level in the past several years, due to concerns of competence under the Treaty”.²⁸⁸ Therefore, ESMA now is in a better situation to take actions for combating market manipulation.

4.2.3.1 ESMA’s center role in collecting and sharing information

In terms of collecting information, ESMA could require competent authorities to provide, without delay, all information necessary to carry out its duties. If the information is not available to the national authorities, it could make request to other EU and national institutions, or even directly to market participants as mentioned previously. Furthermore, when the information is with regard to administrative sanctions and measures imposed on market manipulative cases by the competent authority, it should be provided to ESMA annually. And such annual report obligation is also applied to anonymized and aggregated data regarding all administrative investigations undertaken.²⁸⁹ Similarly, criminal sanctions for the manipulative infringements made by their competent authorities shall be provided to ESMA annually, as well as anonymized and aggregated data regarding all criminal investigations undertaken and criminal penalties imposed by the judicial authorities.²⁹⁰

In terms of sharing information, at the request of a competent authority, ESMA may provide necessary information to facilitate the competent authority to carry out its duties, as long as it does not infringe the professional secrecy.²⁹¹ And the annual report concerning administrative or criminal sanctions and measures imposed by competent authorities shall also be published.²⁹²

4.2.3.2 ESMA’s new power to settle disagreements

²⁸⁸ Fischer-Appelt Dorothee, “The European Securities and Markets Authority: the beginnings of a powerful European securities authority”, *Law and Financial Markets Review*, Volume 5, Number 1, January 2011, pp. 21-32.

²⁸⁹ Market Abuse Regulation, Article 33(1).

²⁹⁰ Market Abuse Regulation, Article 33(2).

²⁹¹ ESMA Regulation, Article 35(3).

²⁹² Market Abuse Regulation, Article 33(1) and (2).

Although competent authorities are obliged to cooperate with each other, it is inevitable that in some cases they do not act within a reasonable time or reject to act without sound reason. Prior to the establishment ESMA, CESR, with the agreement of interested parties, would host a discussion to settle the disagreement. However, as the result of the discussion is not binding, such discussion did not work effectively to resolve complicate problems between national supervisors.

With the arrival of ESMA, this situation is extremely different. ESMA is granted of more powers to resolve disputes between competent authorities.²⁹³ At the first stage, when a competent authority fails to provide information requested, to open an inquiry, or for its officials to take part in on-site inspection by a competent authority that handles a cross-border manipulation case,²⁹⁴ ESMA may coordinate the national authorities in solving the disputation either at the request of one or more competent authorities or on its own initiative in some specified cases.²⁹⁵ During this period, it works as a mediator, trying to resolve the problem without further damages.

However, if the competent authorities fail to settle their disagreement at the first stage, ESMA has a unilateral power to resolve the dispute at the second stage. At the beginning, ESMA may take a decision requiring national regulators to take specific action or to refrain from action in order to resolve the dispute. And this decision is with binding effects for the competent authorities concerned.²⁹⁶ Then if this decision is not complied, ESMA may adopt an individual decision addressed to a financial market participant that fails to comply with Market Abuse Regulation as a result of the behaviour of the competent

²⁹³ Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (hereinafter “Omnibuse Directive”), OJ L 331, 15.12.2010, p. 120–161, Article 3(6).

²⁹⁴ Pierre Schammo, “The European Securities and Market Authority: Lifting the Veil on the Allocation of Powers”, *Common Market Law Review* 48: 1879-1914, 2011, p. 1885.

²⁹⁵ ESMA Regulation, Article 19(1) and (2).

²⁹⁶ ESMA Regulation, Article 19(3).

authority.²⁹⁷ Moreover, the individual decision adopted prevails over any previous decision adopted by the competent authorities on the same matter and their actions shall be compatible with such decision.²⁹⁸

*“Mediation between supervisors will often relate to operational questions where there is genuine uncertainty as to the interpretation of a rule or standard, or uncertainty as to supervisory jurisdiction.”*²⁹⁹ Compared with CESR’s soft mediation powers, ESMA now is in a much better situation to ensure a more efficient and practical solution in cases of disagreement between competent authorities. The power to make binding decisions on national regulators will let ESMA settle sectoral disputes more easily, in particular when there is an emergency. And ESMA’s power to address direct decision to financial market participants, in the circumstance where competent authorities fail to comply with the decision mentioned former, could ensure the smooth functioning and integrity of the financial system. These new powers granted to ESMA certainly will guarantee a better cooperation between national supervisors and enhance the efficient and uniform implementation of EU market manipulation rules.

However, new problems are also created. On the one hand, addressing binding decision directly to individual firms is a big challenge for dividing the line between ESMA’s competences and those of national competent authorities. On the other hand, it is still an ambiguity in relation to the enforcement of the binding decision made by ESMA, in particular when enforcement remains the competence of Member States. So the effect of such decision would weaken if it cannot be enforced.³⁰⁰ Moreover, further guidance on

²⁹⁷ Pierre Schammo, p. 1885.

²⁹⁸ ESMA Regulation, Article 19(4) and (5).

²⁹⁹ Moloney, Niamh, “The European Securities and Markets Authority and institutional design for the EU financial market – a tale of two competences: Part (2) rules in action”, *European business organization law review*, 12 (02), (2011), pp. 177-225.

³⁰⁰ Niamh Moloney, “EU financial market regulation after the global financial crisis: ‘more Europe’ or more risks?”, *Common Market Law Review* 47: 1317-1389, 2010, pp. 1364-1365.

the objective criteria when ESMA may on its own initiative assist the authorities in case of disagreement.³⁰¹

4.3 A more efficient sanctioning regime: administrative sanctions

A harmonized sanctioning regime of market manipulation at EU level will reduce the risk of regulatory arbitrage and support a strong enforcement. Even though Market Abuse Directive has made a tentative foray into the sensitive area of sanctioning powers and liability in Member State, a variation between member states exists in the level of sanctions that can be imposed in market manipulation cases, according to experiences from conducting common investigations.³⁰² For example, market manipulation is sanctioned less severely in some Member States than the others, and criminal sanctions are not applicable in all Member States. As a result the deterrent effect of sanction is limited and perpetrators may make use of the most lenient sanction systems.³⁰³

In particular after the breakout of the global financial crisis, the deep and problematic divergences existing in national sanctioning regimes is considered as a big threaten to the effectiveness of pan-EU enforcement.³⁰⁴ Therefore, it is generally supported by public authorities and private market participants that Market Abuse Regulation provides a higher level of harmonization of sanctions at the EU level as a means to increase their deterrent effect to market manipulation.³⁰⁵

Pursuit to the current market manipulation regime, not all competent authorities enjoy a full set of powers at their disposal, through which they can respond to all situations with

³⁰¹ Fischer-Appelt Dorothee, "The European Securities and Markets Authority: the beginnings of a powerful European securities authority", *Law and Financial Markets Review*, Volume 5, Number 1, January 2011, pp. 21-32.

³⁰² Niamh Moloney, *EC Securities Regulation*, p. 1002.

³⁰³ Commission, Commission Staff Working Paper Impact Assessment, SEC(2011) 1217 final, pp. 31-32.

³⁰⁴ The de Larosi ère Report, p. 23 and pp. 51-52.

³⁰⁵ Niamh Moloney, *EC Securities Regulation*, pp. 1001-1003. And also see contributions to the European Commission Public Consultation on A Revision of the Market Abuse Directive (MAD) (2010), available at http://ec.europa.eu/internal_market/consultations/2010/mad_en.htm.

the appropriate sanction corresponding to the severity of manipulative behaviours.³⁰⁶ Market Abuse Regulation makes a credible change in this part. In order to ensure a uniform application at the EU level, it provides some common standards with regard to administrative sanctions of market manipulation that Member States should respect.

4.3.1 A minimum set of administrative sanctions and measures³⁰⁷

Unlike Market Abuse Directive, which allows Member States to determine appropriate sanctions for market manipulation, Market Abuse Regulation provides a set of administrative sanctions and measures that should be empowered to competent authorities. And these administrative sanctions or measures could be classified into two categories: monetary sanctions and non-pecuniary sanctions.

4.3.1.1 Monetary sanctions of market manipulation

Administrative fine is an efficient deterrence of market manipulation. Given the large gains that could be obtained from manipulating investment instruments in the financial market, sufficient high fines should be allowed for national supervisors to impose effective, proportionate, and dissuasive fines. However, according to the report issued by ESMA on the actual use of sanctioning powers under Market Abuse Directive, administrative fines apparently vary among Member States. For instance, the lowest sanction that is imposed on nature person for market manipulation ranged from €100 (France) to €134,060 (the UK) while the highest sanction imposed ranged from €405 (Lithuania) to €1,500,000 (France). And the lowest sanction imposed on legal persons

³⁰⁶ For example, in 6 Member States there is no possibility to withdraw the authorisation in case of violations of the Market Abuse Directive. 15 Member States do not provide for the disqualification/dismissal of the management and/or supervisory body in cases involving market manipulation under this Directive. See Commission, Commission Staff Working Paper Impact Assessment, SEC(2011) 1217 final, p. 25.

³⁰⁷ “Administrative measures” are contemplated as an alternative to “administrative sanctions” here. See Guido A. Ferrarini, “The European Market Abuse Directive”, *Common Market Law Review* 41: 711–741, 2004, p. 741.

ranged from €575 (Estonia) to €4,556,328 (the UK) while the highest amount imposed ranged from €575 (Estonia) to €5,000,000 (Portugal).³⁰⁸

The large divergences of national administrative fines may tempt financial market participants to engage in regulatory arbitrage, by which they could benefit from the most lenient sanctioning regimes, whereas this will lead to distortions of competition in the internal financial market.³⁰⁹ Therefore, a maximum level of administrative pecuniary sanctions is provided in Market Abuse Regulation taking into account the amount of the profits gained or losses avoided because of the infringement. Details of the amount of fines are showed in Table 3.

Table 3 Maximum level of administrative fines for market manipulation³¹⁰

	Nature Person	Legal Person ³¹¹
Perpetrators of manipulative conducts ³¹² (at least)	EUR 5 000 000	EUR 15 000 000 or 15 % of the total annual turnover
Person concerning prevention and detection of market manipulation ³¹³ (at least)	EUR 1 000 000	EUR 2 500 000 or 2 % of its total annual turnover

³⁰⁸ ESMA, “Report: Actual use of sanctioning powers under MAD”, 26 April 2012, ESMA/2012/270, p. 55.

³⁰⁹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Reinforcing sanctioning regimes in the financial services sector, (hereinafter “Communication on Reinforcing sanctioning regimes in the financial services sector”) 8 December, 2010, COM(2010) 716 final, p. 10.

³¹⁰ Market Abuse Regulation, Article 30(2)(h)(i) and (j). And for the Member States whose currency is not the euro, the fine is the corresponding value in the national currency on 2 July 2014.

³¹¹ If the legal person is a parent undertaking or a subsidiary, the calculation of the total turnover is subject to paragraph 2 of the Article 30(2) of the Regulation.

³¹² Infringements of Article 15 of Market Abuse Regulation

³¹³ Infringements of Article 16 of Market Abuse Regulation

Managers and investment advisors ³¹⁴ (at least)	EUR 500 000	EUR 1 000 000
Overarching minimum fine applicable to market manipulation	At least three times the amount of the profits gained or losses avoided	

From this table, it could be concluded that the new sanctioning regime establishes a harsh level of administrative fines,³¹⁵ which, on the one hand, has a better effect for deterrence of market manipulation; on the other hand, lessening the divergences among Member States.

4.3.1.2 Non-pecuniary sanctions of market manipulation

Compared with monetary fines, the non-pecuniary sanctions play a more important role in preventing a repeated offender and in reducing further damages. A minimum set of non-pecuniary sanctions is provided by Market Abuse Regulation, including orders for ceasing and desisting manipulative conduct, orders for disgorgement of profits or losses, public warnings, withdrawal or suspension of regulatory authorizations of an investment firm, and temporary or permanent bans on the exercising of management functions by the managers implicated in the breach.³¹⁶

Further, measures stipulated in Article 23 of the Regulation should also be available to competent authorities, which cover a request to freeze or sequester assets, a suspension of trading of the financial instrument concerned, a temporary cessation of any practice that the competent authority considers contrary to this Regulation and temporary prohibition on the exercise of professional activity.³¹⁷

³¹⁴ Infringement of Article 19 and 20 of Market Abuse Regulation

³¹⁵ Mathias Siems and Matthijs Nelemans, “The Reform of the EU Market Abuse Law: Revolution of Evolution?”, *Maastricht Journal of European and Comparative Law* (2012), p. 10.

³¹⁶ Market Abuse Regulation, Article 30(2). Also see “European Union Overhauls Insider Dealing and Market Abuse Regime”, Cleary Gottlieb news, July 1, 2014.

³¹⁷ Market Abuse Regulation, Article 23.

In general, the clear list of administrative sanctions will avoid the situation that effective measures are not provided in all national legislations. Take public warning for example, it is not available in some Member States. However, this measure is an effective prevention of market manipulation, as it indicates the person responsible for a manipulative case and the nature of the infringement. It can make a significant contribution to general prevention, which not only helps the public to understand typical behaviours subject to sanctions, but also makes a public humiliation of perpetrators.³¹⁸

Since Market Abuse Regulation only makes a minimum harmonization of administrative sanctions and measures, Member States has the right to grant competent authorities more powers and to provide for higher levels of sanctions than that established in the new rules.³¹⁹ Such as the maximum administrative pecuniary sanctions rule is in fact the minimum requirement of maximum fines. It means that the upper limit for fines shall not be lower than the amount stated above, while Member States are allowed to provide a higher level. This minimum harmonization approach is agreed by ESMA, *“taking into consideration that the appropriate sanction in a particular enforcement case depends on the unique circumstances of each case, it is considered that minimum harmonization would be more appropriate than maximum harmonization”*.³²⁰

4.3.2 Appropriate factors to be taken into account in determining administrative sanctions

Sanctions of market manipulation are the competence of national regulators, so divergences would be created if competent authorities take consideration of different criteria when determining the type and level of administrative sanctions. However, such criteria vary across Member States, because Market Abuse Directive did not make any rules concerning this section. According to the actual enforcement, only four common factors (seriousness of the violation; duration; impact on market; and level of

³¹⁸ Communication on reinforcing sanctioning regimes in the financial services sector, p. 12.

³¹⁹ Market Abuse Regulation, Article 30(3).

³²⁰ Commission, Commission Staff Working Paper Impact Assessment, SEC(2011) 1217 final, p. 5.

responsibility or seniority) were actually used by seven national authorities that had imposed administrative sanctions from 2008 to 2010.³²¹

As a result, Market Abuse Regulation makes a minimum list of common key factors that are required to take into account by competent authorities when making administrative penalties. Factors included are the gravity and duration of the violation; the degree of responsibility and financial strength of the manipulator; the importance of the profits gained or losses avoided; cooperative behaviours with the competent authority; previous infringements by perpetrator; and measures taken to prevent the repetition of infringement.³²² Also, these factors are actually used by at least 15 competent authorities in deciding sanctions.³²³

The provisions concerning common factors could make a maximum harmonization of various criteria for imposing administrative sanctions in Member States. Furthermore, in terms of cross-border manipulative cases, competent authorities shall coordinate their actions in order to avoid duplication and overlaps when imposing administrative sanctions, and ensure the sanction imposed to be effective, proportionate and dissuasive.

4.3.3 Publication of sanctioning decisions

Publication of administrative sanctioning decisions is the so called “naming-and-shaming” strategy. It is an effective way to deter market manipulation given reputational risk,³²⁴ and is also a useful tool to inform the public of what is manipulative behaviour as well as to promote good behaviour among market participant.³²⁵ Even though the use of “naming-and-shaming” strategy is identified as an important achievement of Market Abuse Directive,³²⁶ this method is not applicable in all the Member States.³²⁷ Taken into

³²¹ ESMA, “Report: Actual Use of Sanctioning Power under MAD”, 26 April 2012, ESMA/2012/270, p. 65.

³²² Market Abuse Regulation, Article 31(1).

³²³ ESMA, “Report: Actual Use of Sanctioning Power under MAD”, 26 April 2012, ESMA/2012/270, p. 61.

³²⁴ Moloney, EC Securities Regulation, p. 1000

³²⁵ Market Abuse Regulation, Recital 73.

³²⁶ CESR, “An Evaluation of Equivalence of Supervisory Powers in the EU under the Market Abuse Directive and the Prospectus Directive: A Report to the Financial Services Committee (FSC)” (June 2007), CESR 07-334b.

account the importance of the publicity of decisions, the new regulation makes a further harmonization in this section.

Firstly, competent authorities are obligated to disclose any decision that imposes an administrative sanction or other administrative measure relating market manipulation. Such decisions should be published on the regulators' website immediately after the perpetrator has been informed.³²⁸ ESMA should be notified simultaneously when competent authorities make the disclosure.³²⁹ The decisions disclosed are of a sanctioning nature, not including those of an investigatory nature. The content of the publication shall include at least information in relation to the type and nature of the infringement and the identity of the person subject to the decision.³³⁰ Moreover, the decision is subject to publish even if it is appealed, and information as well as any subsequent information regarding the outcome of such an appeal also needs to be disclosed. And the same rules apply to annulment of such decision.³³¹

Secondly, there are several exceptions for the general rule of publicity in case of disproportionate damage to the persons involved or jeopardizing the stability of financial markets or an ongoing investigation the competent authority.³³² Competent authorities could delay the publication or publish the decision on an anonymous basis to ensure the effective protection of the personal data concerned.³³³ And the competent authorities can only deny publishing the administrative sanctions and measures when the anonymous or delayed publication could not realize the purpose pursued or such publication is not complied with the principle of proportionality.³³⁴ So delay publication and the anonymous

³²⁷ 11 Member States (AT, BG, DE, CY, EE, EL, IS, LU, LV, PL, SI) do not require that administrative decisions to be published. See ESMA report on the actual use of sanctions, p.134.

³²⁸ Market Abuse Regulation, Article 34(1).

³²⁹ Market Abuse Regulation, Article 33(3).

³³⁰ Market Abuse Regulation, Article 34(1)

³³¹ Market Abuse Regulation, Article 34(3).

³³² Market Abuse Regulation, Article 34(2).

³³³ The anonymous publication could change into delay publication if the reasons for anonymous publication will cease to exist in a reasonable period of time.

³³⁴ Market Abuse Regulation, Article 34(1), Paragraph 3.

publication are two measures that the new regulation uses to reduce the situation of non-publication.

And lastly, record-keeping is an important measure for establishing an efficient and transparent sanctioning mechanism.³³⁵ Competent authorities are obliged to keep record of the publication of decisions on their website for a period of at least five years after their publications. Relating personal data shall also be kept on the website in accordance with the applicable data protection rules.³³⁶ Keeping the record of such publication could strengthen the shaming effect for perpetrators and lead to better deterrence of misconduct in financial market.

The new rules concerning publicity of decisions ensures a dissuasive effect of the decisions that impose administrative sanctions and measures on the public at large. It generally changes the divergent regulation in Member States and keeps the affected parties from disproportionate damages.³³⁷ However Market Abuse Regulation only makes a minimum harmonization, leaving more space for Member States. For example, national legislators could decide the format and content of the publication, the disclosure of investigating measures, or the criteria used to determine whether publishing a decision that is not required to disclose in principle.

4.4 A more efficient sanctioning regime: criminal sanctions

An equal, strong and deterrent sanctioning regime against financial misconducts is the basis of sound and integrated financial markets.³³⁸ The current market manipulation regime seeks to improve the enforcement of the market manipulation prohibition primarily

³³⁵ Van Dyck, Tom, "The Review of the Market Abuse Regime in Europe" (February 12, 2010), available at SSRN: <http://dx.doi.org/10.2139/ssrn.1558342>, last visited on 5 March 2015.

³³⁶ Market Abuse Regulation, Article 34(3).

³³⁷ Veil, Ruediger and Koch, Philipp, "Towards a Uniform European Capital Markets Law: Proposals of the Commission to Reform Market Abuse" (February 2, 2012), Bucerius Law School Working Paper No. 1/2012.

³³⁸ The de Larosi ère Report, p.24

through administrative procedures and sanctions.³³⁹ In terms of whether or how to impose criminal sanctions, it is totally up to Member States. However, the global financial crisis reveals that the present Member States sanctioning regimes are in general weak and heterogeneous, therefore lack of sufficient deterrent effect.³⁴⁰ Given the fact that “*criminal sanctions demonstrate social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law*”³⁴¹, an introduction of criminal sanctions to serious manipulative offences is expected to enhance the deterrence.³⁴²

This idea of harmonising criminal sanctioning regime in Member States is strengthened by the occurrence of the Libor scandal. A serious case of benchmark manipulation has exposed relevant problems and loopholes, which impact gravely on market confidence and might result in significant losses to investors as well as distortions of the real economy.³⁴³ Furthermore, divergences existing in national criminal sanctions leave a certain space for perpetrators to take advantage of the most lenient criminal system across the Union. As a result, an approximation of criminal sanctions for market manipulation is essential to ensure the effective implementation of Union policy on fights market abuse.³⁴⁴

³³⁹ Guido A. Ferrarini, “The European Market Abuse Directive”, *Common Market Law Review* 41: 711–741, 2004.

³⁴⁰ See the de Larosière Group Report (2009) and ESMA’s report on the actual use of sanctioning powers under Market Abuse Directive (2012).

³⁴¹ European Commission, “Directive on criminal sanctions for market abuse – Frequently Asked Questions”, Commission MEMO/14/78.

³⁴² As stated by the Internal Market and Services Commissioner Michel Barnier: “Sanctions for market abuse today are too divergent and lack the necessary deterrent effect. By imposing criminal sanctions for serious market abuse throughout the EU we send a clear message to deter potential offenders – if you commit insider dealing or market manipulation you face jail and a criminal record. These proposals will heighten market integrity, promote investor confidence and level the playing field in the internal market.” See European Commission, “European Commission seeks criminal sanctions for insider dealing and market manipulation to improve deterrence and market integrity”, IP/11/1218, 20, October 2011.

³⁴³ Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive), hereinafter “Directive on criminal sanctions for market abuse”, preamble 7.

³⁴⁴ *Ibid*, preamble 8

4.4.1 Article 83(2) TFEU and criminal sanction on market manipulation

As provided in Article 83(2) of the Treaty on the Functioning of the European Union (TFEU), criminal law can be used as a regulatory tool to ensure the effective implementation of European Union policies. The financial sector, market manipulation or insider dealing for instance, is a subject covered by the scope of EU policies.³⁴⁵ Accordingly, EU has the right to adopt directives to set minimum rules on both the definition of offences and on their sanctions. However, the harmonization of criminal law is subject to two constraints: one is that criminal measures adopted should be essential to ensuring the effective implementation of an EU policy; and the other one is concerning the area that must already have “*been subject to harmonization measures*”.³⁴⁶

The EU rules on market abuse are a case in point where criminal law could be a useful additional tool to ensure effective enforcement.³⁴⁷ As analysed, the administrative sanctioning regime for market manipulation provided in the Market Abuse Directive is weak and heterogeneous, and divergent criminal definitions of offences and imposition of penalties in Member States enable perpetrators to choose jurisdiction with less strict sanctioning regime, which could further undermine the integrity of internal financial market. In the absence of a common EU framework, national initiatives cannot ensure consistency in the reinforcement of sanctioning regimes.³⁴⁸ Therefore, greater convergence between national criminal sanctioning regimes concerning market manipulation can mitigate divergences among Member States, increase the deterrent effects and ensure a better implementation of the Union policy to combat market abuse.³⁴⁹

³⁴⁵ European Commission Communication, Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law”, p.10.

³⁴⁶ Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law: cases and materials*, Cambridge University Press, 2010, the second edition, p. 617.

³⁴⁷ European Commission, “Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law”, 20 September, 2011, COM (2011) 573 final.

³⁴⁸ Libor Klimek, “Effective enforcement of sanctions for market abuse in the EU: introduction of criminal sanction”, in the *Zech Yearbook of International Law*, Juris Publishing Inc., p.114.

³⁴⁹ Marta Miglietti, “The New EU Criminal Law Competence in Action: The Proposal for a Directive on Criminal Sanctions for Insider Dealing and Market Manipulation”, IES working paper 5/2013.

The Directive on criminal sanctions for market abuse is adopted by the European Parliament and the Council on 16 April 2014. This is the first time that the EU has used the criminal law competences conferred by Article 83(2) TFEU.³⁵⁰ The Directive sets out minimum criminal rules with regard to the definitions of market manipulative offences and criminal sanctions, such as a term of imprisonment for four years, in order to make sure the punishment effective, proportionate and dissuasive. Besides, such common minimum rules are also considered to facilitate the cooperation of law enforcement and judicial authorities in the Union, particularly in cases of cross-border offences.

However, it is not out of controversy to use Article 83(2) TFEU as the legal basis of the Directive on criminal sanctions for market abuse. It is argued that the Directive does not satisfy the “essential requirement” of Article 83(2), as no concrete evidence is provided by the European Commission to prove that the sufficient implementation of market abuse rules cannot be guaranteed by sanction regimes of administrative or civil nature,³⁵¹ and accordingly criminal sanction is a measure of last resort.³⁵² Further, there is also no actual evidence to prove the occurrence of such displacement of criminal activities and the consequences which this would have. Even though the report on the actual use of sanction powers issued by ESMA and the European Commission’s impact assessment paper concerning market abuse regulation make certain supplements, the problem that the evidences for harmonizing criminal sanctions for market manipulation are still too general and conceptual.

³⁵⁰ Steve Peers, “Jailing the bankers: the new EU Directive on criminal penalties for market abuse”, 4 February 2014, available at <http://eulawanalysis.blogspot.it/2014/02/jailing-bankers-new-eu-directive-on.html>.

³⁵¹ Marta Miglietti, “The New EU Criminal Law Competence in Action: The Proposal for a Directive on Criminal Sanctions for Insider Dealing and Market Manipulation”, IES working paper 5/2013, p.33.

³⁵² “The introduction of common definitions of the most serious market abuse offences and a requirement for Member States to put in place criminal sanctions is expected to contribute to a more effective investigation and prosecution of such crimes by offering a new tool to address market abuse. ***This would complement administrative measures and sanctions.***” Commission Staff Working Paper, Impact Assessment Accompanying the document Proposal for a Regulation on insider dealing market manipulation (market abuse) and the Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation. See Commission, Commission Working Staff Paper Impact Assessment, SEC (2011) 1217, final, p.166.

4.4.2 A general introduction of the Directive on criminal sanctions for market abuse

Directive on criminal sanctions for market abuse is separately adopted, as a limb of Market Abuse Regulation, considering that the harmonization of criminal law could only be done by means of directives.³⁵³ It aims to increase the deterrent effects of the market abuse regime by raising the level and aggression of enforcement activity across the EU.³⁵⁴ This Directive is in line with the scope of Market Abuse Regulation and reprises much of its wording, including the financial instruments concerned, the definition of the core market abuse offences, and exclusions and exemptions. To keep pace with the faster development of current financial market, the new criminal sanctioning regime of market manipulation targets not only financial instruments traded on regulated markets, on MTF and on OTF, but also spot commodity contracts, derivative contracts or derivative instruments, as well as benchmarks.³⁵⁵

Also aligned with the scope of Market Abuse Regulation, a group of transactions for certain purposes are not deemed to criminal penalties, which include buy-back programmes and stabilization of securities; transactions, orders or behaviours in the pursuit of monetary, exchange-rate or public debt management policy in compliance of certain conditions and procedures; and activities in the pursuit of the Union's Climate Policy, the Union's Common Agricultural and the Union's Common Fisheries Policies.³⁵⁶

In addition, the scope of the Directive on criminal sanctions for market abuse is designed to complement and ensure the effective implementation of Market Abuse Regulation.³⁵⁷ Member States are free to choose the type of liability to impose for infringement of market manipulation. Administrative and criminal penalties could be imposed for the same

³⁵³ TFEU, Article 83.

³⁵⁴ Cheryl Jones, "Casting a wider net to catch market abuse", May 14, 2014, Available at <http://blogs.lexisnexis.co.uk/fs/casting-a-wider-net-to-catch-market-abuse/>.

³⁵⁵ Directive on Criminal Sanctions for Market Abuse, Article 1(2) and (4).

³⁵⁶ Cleary Gottlieb news, "European Union Overhauls Insider Dealing and Market Abuse Regime", July 1, 2014, available at <http://www.cgsh.com/european-union-overhauls-insider-dealing-and-market-abuse-regime/>, last accessed on 26 October 2014.

³⁵⁷ Directive on Criminal Sanctions for Market Abuse, preamble 23

offence in accordance with national law, while the principle of *ne bis in idem* should be ensured not to be breached. However, maintenance of criminal sanctions rather than administrative sanctions for infringement regarding market manipulation could be allowed and such decision should be notified to the European Commission and to ESMA.³⁵⁸ The choice of only imposing criminal sanctions should not reduce or otherwise affect the ability of competent authorities to cooperate and access and exchange information timely with competent authorities in other Member States.³⁵⁹

Furthermore, Directive on criminal sanctions for market abuse provides a wide scope of jurisdiction. Criminal sanctions are at least applicable to market abuse committed in whole or in part within a Member State, or the offence is perpetrated by a Member State national in a territory where the act is a breach of law.³⁶⁰ Besides, the Directive extends its jurisdiction to offences committed outside the territory of a Member State if the offender is a habitual resident in its territory; or the offence is committed for the benefit of a legal person established in its territory.³⁶¹ Although this broad scope of jurisdiction guarantees a Member States to have the right to investigate and punish the market manipulation that infringes the interest of a Member State or its nationals, it, at the same time, may cause serious issue of overlap of jurisdictions. To resolve this problem, a closer cooperation between competent authorities in Member States and third countries is critical.

4.4.3 Offences of market manipulation subject to criminal sanctions

According to the Directive on criminal sanctions for market abuse, insider dealing, unlawful disclosure of inside information and market manipulation are three types of offences that are subject to criminal sanction. It is not appropriate to impose crimination for all the manipulative behaviours, taking consideration of the long and high resource consuming proceedings, poor expertise of prosecutors, and low harmonization of

³⁵⁸ Market Abuse Regulation, Article 30(1)(b).

³⁵⁹ Market Abuse Regulation, Preamble 72.

³⁶⁰ Directive on criminal sanctions for market abuse, Article 10(1)

³⁶¹ Directive on criminal sanctions for market abuse, Article 10(2)

cooperation rules.³⁶² Hence, only manipulative offences that are of seriousness and committed with intent are subject to criminal sanctions according to the Directive.

The first key element for deciding criminal manipulation offence is “seriousness”. “Seriousness” should be determined taking into account several factors, which include impact on market integrity, gain derived or loss avoided, level of damage caused to the market, level of alteration of the value of the financial instrument or spot commodity contracts, or amount of funds originally used, and position of the perpetrator.³⁶³ For example, if manipulative activities are committed by a market professional or an officer in a supervisory authority, they should be judged as serious, since the perpetrator is a person who is supposed to be trusted by the market participants and has the duty to maintain the sound function of financial market.

The other key element is “intent”. Act constituting a criminal offence should be committed with intent. Although the market abuse regime in general in the EU appears to be an “effect-based” regulation,³⁶⁴ the mental state is still a necessary requirement for imposing criminal sanction, which is not the same as administrative sanction. Given the severity of criminal sanction, not requiring the intent element may raise uncertainty and potential injustice. Moreover, since Directive on criminal sanctions for market abuse only makes a minimum harmonisation, it does not preclude Member States to provide that market manipulation committed recklessly or by serious negligence constitutes a criminal offence.³⁶⁵

Excepting those two general requirements, criminal offences of market manipulation could be committed by four general methods: manipulation by disseminating false or misleading information; manipulation based on transactions or orders to trade, either by giving misleading signals or by securing an artificial price in the absence of an accepted

³⁶² Commission, Commission Working Staff Paper Impact Assessment, SEC (2011) 1217 final, p.167.

³⁶³ Directive on criminal sanctions for market abuse, preamble 12

³⁶⁴ Edward J Swan and John Virgo, *Market Abuse Regulation*, Oxford University Press, second edition, p.96.

³⁶⁵ Directive on Criminal Sanctions for Market Abuse, preamble 21

market practice; manipulation by employing a fictitious device, deception or contrivances; and manipulation of benchmark.³⁶⁶ Although these four categories of activities are generally in line with that provided in the Market Abuse Regulation, there still are several different points that are worthy to mention.

(a) Unlike rules in Market Abuse Regulation, Directive on criminal sanctions of market abuse only applies to behaviours that do create a manipulative effect, precluding those activities which are merely “likely” to cause such an effect.³⁶⁷ This strengthens the fact that criminal sanctions only target the serious case of market manipulation, not all of them.

(b) Attempted market manipulation should also be punished as a criminal offence if its realization may create serious adverse effects on the integrity of the financial markets and on investor confidence in those markets.³⁶⁸ Furthermore, the Directive also criminalizes the offences in relation to inciting, aiding and abetting market manipulation.

And (c) manipulation of benchmark, as a newly added type of market manipulation, is now subject to criminalization. Manipulation of benchmark, such as the Libor scandal, is the worst kind of market manipulation. However, the perpetrators in the scandal in Europe have been sent to the US to face the full force of the law, because criminal liability was not required by the EU rules. With the Directive entering into force, such embarrassing situation will be changed.³⁶⁹ Benchmarks manipulators now are also subject to punishment of imprisonment in the Union.

4.4.4. Manipulators subject to criminal sanctions

The prohibition of market manipulation applies to any person, which means that both natural and legal persons are in face of criminal liability for committing offences related.

While there barely are arguments for imposing criminal sanctions on natural person, the

³⁶⁶ Ibid, Article 5.

³⁶⁷ Cleary Gottlieb news, “European Union Overhauls Insider Dealing and Market Abuse Regime”, July 1, 2014, available at

<http://www.cgsh.com/european-union-overhauls-insider-dealing-and-market-abuse-regime/>.

³⁶⁸ Directive on Criminal Sanctions for Market Abuse, preamble 13

³⁶⁹ Presentation of Arlene McCarthy, Debate at the European Parliament on 4 February 2014.

introduction of criminal sanction for legal person could be describe as a great shock. With the growing presence and importance, legal persons play an even more important role than nature persons in the financial market. In some circumstance, it is the financial institution as a whole that should be responsible for the manipulative infringement, so imposing criminal sanction only on its employees involved might not have the expected deterrent effects.³⁷⁰ In addition, because of the potential stigmatizing effect of criminal sanctions³⁷¹, a legal person may have more motives to take the organizational measures and provide staff trainings that are effective methods to prevent infringements.³⁷²

In order to impose criminal sanction on a legal person, certain conditions must be satisfied. On the one hand, the criminal offences must be committed for the benefit of the legal person, not for its employees. On the other hand, such offence is perpetrated, no matter acting individually or as part of an organ of the legal person, by either:

a) A person who has a leading position within the legal person, no matter acting individually or as part of an organ of the legal person. The leading position here could be based on: a power of representation of the legal person; an authority to take decisions on behalf of the legal person; or an authority to exercise control within the legal person.³⁷³

This type of person is in fact a representative organ of the corporation or a member of such an organ, for instance corporate directors or even the *de facto* directors, or

b) A person subject to the authority of persons indicated previously, in other words, the lower level officers, employees or agents,³⁷⁴ and whose misconduct is a result of the

³⁷⁰ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Reinforcing sanctioning regimes in the financial services sector, (hereinafter “Communication on Reinforcing sanctioning regimes in the financial services sector”) 8 December, 2010, COM(2010) 716 final, p.13.

³⁷¹ Ibid.

³⁷² V.S. Khanna, “Corporate Criminal Liability: What Purpose Does It Serve?”, *Harvard Law Review*, Volume 109, May 1996, number 7, p. 1497.

³⁷³ Directive on criminal sanctions for market abuse, Article 8(1).

³⁷⁴ Joanna Kyriakakis, “Corporate Criminal Liability and the ICC Statute: the Comparative Law Challenge”,

Netherlands International Law Review, Volume 56, Issue 03, December 2009, pp 333 – 366.

lack of supervision or control of the high hierarchy person. *“This lack of surveillance can be based on flaws in the company’s organization.”*³⁷⁵

Despite that the imposition of criminal sanctions on legal person for the serious market manipulation offences is considered as an appropriate measure to ensure effective implementation of the EU rules concerning the prohibition of market manipulation,³⁷⁶ it at the same time opens up the question of corporate liability across Europe more generally.

Although the criminal liability of legal person becomes common in Europe, there still are Member States that criminal liability of legal person is not foreseen in national law.³⁷⁷

And Germany’s view on the criminal liability of legal is probably the most sceptical and restrictive of the principal European nations.³⁷⁸ Criminal law in Germany does not

“tolerate the fiction that a corporation had done anything, let alone possessed the mens rea necessary to be convicted a crime”.³⁷⁹ Nevertheless, the current sanctioning regime

in Germany is as effective as any criminal sanction,³⁸⁰ with extension of criminal law to individual corporate directors and agents and a combination of administrative and civil

law remedies to regulate and punish the corporation itself.³⁸¹ So is it really necessary to introduce criminal sanction for legal person across EU for preventing market

³⁷⁵ Ibid, p. 343.

³⁷⁶ Commission, “Commission Working Staff Paper Impact Assessment”, SEC (2011) 1217 final, p.167

³⁷⁷ These five Member States include Germany, Greece, Latvia, Sweden and Bulgaria. However, for Bulgaria, it must mention that in 2005 their legislation introduced a specific “administrative-criminal liability” for legal person. See G. Vermeulen, W. De Bondt and C. Ryckman, *Liability of legal persons for offences in the EU* (IRCP-series, vol. 44), Maklu publisher, 2012, p.31.

³⁷⁸ J.C. Coffee, “Corporate Criminal Liability: An Introduction and Comparative Study”, in A. Eser, G. Heine and B. Huber, eds., *Criminal Responsibility of Legal and Collective Entities* (Freiburg im Breisgau, edition iuscrim 1999), pp. 9-14.

³⁷⁹ Edward B. Diskant, “Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine Through Comparative Criminal Procedure” 118 Yale L.J. 126 (2008), p.144.

³⁸⁰ Clifford Chance LLP, “Corporate Liability in Europe”, available at http://www.cliffordchance.com/content/dam/cliffordchance/PDFs/Corporate_Liability_in_Europe.pdf, last assessed on 4 November 2014.

³⁸¹ Edward B. Diskant, “Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine through Comparative Criminal Procedure”, *the Yale Law Journal*, 118 Yale L.J. 126 (2008), p.142.

manipulation? No concrete evidence or explanation is provided by the European Commission,³⁸² and it can only be proved by the practice in the future.

4.4.5. Types and levels of criminal sanctions for market manipulation

4.4.5.1 A general requirement of criminal sanctions

In general, the criminal sanctions on nature persons and legal persons, who commit serious manipulative offence with intent, are required to be effective, proportionate and dissuasive by the Directive on criminal sanctions for market abuse. However, both the old and new market manipulation regulations do not establish any criteria for assessing “effective, proportionate and dissuasive”. It is up to national legislation to define those criteria.

None the less, certain hints are provided in the preamble of the Directive states that “*the imposition of sanctions should be proportionate, taking into account the profits made or losses avoided by the person liable as well as the damage resulting from the offence to other persons and, where applicable, to the functioning of markets or the wider economy*”³⁸³. Of all these factors, the profits made or losses avoided is confirmed by the case law.³⁸⁴ Besides, hypothetical criminal sanction which may subsequently be imposed does not influence the assessment of how effective, proportionate and dissuasive the administrative sanctions are.³⁸⁵

4.4.5.2 A minimum list of available types of criminal sanctions

Directive on criminal sanctions for market abuse makes a minimum harmonization of the level and types of criminal sanctions for manipulation. In terms of nature person, a maximum term of imprisonment term of at least four years should be applicable to the person who commits manipulation in order to ensure the sanction effective. In terms of

³⁸² Veil, Ruediger and Koch, Philipp, “Towards a Uniform European Capital Markets Law: Proposals of the Commission to Reform Market Abuse” (February 2, 2012), Bucerius Law School Working Paper No. 1/2012, pp.23-24

³⁸³ Directive on Criminal Sanctions for Market Abuse, preamble 24

³⁸⁴ CJEU, Case C-45/08, paragraph 73.

³⁸⁵ Ibid, paragraph 76-77.

legal person, the sanctions imposed shall include unquantified criminal or non-criminal fines and may include other sanctions, such as exclusion from entitlement to public benefits or aid; temporary or permanent disqualification from the practice of commercial activities; placing under judicial supervision; judicial winding-up; temporary or permanent closure of establishments implicated in the wrongful conducts.³⁸⁶

4.4.5.3 Key elements harmonised by the Directive

In order to increase the deterrent effects of market manipulation regime and to ensure uniform enforcement in Member States, Directive on criminal sanctions for market abuse clarifies some key elements to reduce the possibility of ambiguity during the application:

Firstly, Directive on the criminal sanctioning for market abuse provides for minimum rules, therefore Member States are free to provide the maximum sentence of more than four years or maintain the period of imprisonment of four years in their national law. Secondly, liability of legal person shall be distinguished from that of natural person who are involved as perpetrators, inciters or accessories in the offences. Natural persons and legal persons could be sanctioned at the same time. Thirdly, the sanctioning scheme of legal person does not preclude imposition of pecuniary penalty along with other non-pecuniary measures, such as placement of an entity under judicial surveillance, which prevents the entity from committing crimes in the future.³⁸⁷ And finally, the publication of a final decision on a sanction could be adopted by the Member States as a dissuasive measure to prohibit market manipulation. The publication could include the identity of the liable legal person, taking into account fundamental rights, the principle of proportionality and the risks to the stability of financial market and ongoing investigations.³⁸⁸

³⁸⁶ Directive on Criminal Sanctions for Market Abuse, Article 7(2) and Article 9

³⁸⁷ Martin Böse, "Corporate Criminal Liability in Germany", in Mark Pieth, Radha Ivory (editors), *Corporate Criminal Liability: Emergence, Convergence, and Risk*, Springer Science and Business Media B.V. 2011, p. 250.

³⁸⁸ Directive on Criminal Sanctions for Market Abuse, preamble 18

4.4.6 Issues concerning the sanctioning regime of market manipulation

The introduction of criminal sanction for market manipulation is not considered as a total success. Firstly, the criminal sanctions are treated as complement of administrative sanctions provided in Market Abuse Regulation, not as a last resort, to resolve the issue that previous sanctioning regime does not ensure sufficient deterrent effects for market manipulation. Therefore, it is argued by many commentators that the harmonization of criminal law concerning market abuse does not satisfy the conditions to use Article 83(2) as a legal basis.

Secondly, according to the Directive, only “serious” offences are punishable by criminal sanctions. Even though several factors are suggested to take into account when determining seriousness, “*the exact perimeter of the criminal sanctioning regime will remain uncertain and harm the Commission’s goal of harmonization*”³⁸⁹. Thirdly, the new jurisdiction provision aims to prevent from omitting market manipulation, in particular cross-border cases, however it worsen the issue of jurisdiction overlap, challenging the principle of home Member States.

And finally, disagreements still exist in relation to the necessary of imposing criminal sanctions on legal person. As in some Member States, particular Germany, it does not conform to their traditional criminal legal theory that legal person is held liable of criminal liability. And most of the functions of criminal liability of legal person could be replaced by civil liability, administrative liability and criminal liability of nature person, either individually or in combination. As a result, the criminal liability of legal person would only be socially desirable in a few rarest circumstances, given that “*the higher sanctioning*

³⁸⁹ Cleary Gottlieb news, “European Union Overhauls Insider Dealing and Market Abuse Regime”, July 1, 2014, available at <http://www.cgsh.com/european-union-overhauls-insider-dealing-and-market-abuse-regime/>, last accessed on 21 October 4014.

*costs of stigma penalties and the increased costs of deterring corporate misbehavior created by the procedural protections of criminal law”.*³⁹⁰

Conclusion of Chapter 4

Enforcement is a critical element for the success of EU’s market manipulation regime. However, the prohibition of market manipulation is notoriously difficult to enforce, taking consideration of the fact that the detection and control of manipulative behaviours are heavily dependent on action by actors.³⁹¹ Market Abuse Regulation tries to enhance the efficiency of supervision and enforcement relating to this prohibition through four main aspects.

Firstly, powers of competent authorities have been enhanced to support effective intra-Member State and cross-border supervision. The new market manipulation regime aims to ensure equivalence in supervisory powers by providing a minimum list of powers that should be conferred on national regulators. New and strengthened powers are provided, in particular the right to require telephone and data traffic from telecommunications operations (as well as from investment firms), the right to request information from related spot market participants directly according to standardized formats, the right to obtain transaction reports and to have direct access to traders’ systems.

Secondly, supervisory cooperation has been extended on the basis of that set out in Market Abuse Directive. The scope of information and subjects subject to the information-sharing system will be wider, and requesting competent authorities will have more options during the investigatory cooperation. More significantly, ESMA, taking the place of CESR, will play a more active role in the supervisory cooperation mechanism. It is not limited to the role of mediator, but also could impose directly binding decisions on

³⁹⁰ V.S. Khanna, “Corporate Criminal Liability: What Purpose Does It Serve?”, *Harvard Law Review*, Volume 109, May 1996, number 7, p.1533.

³⁹¹ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, pp. 754-755.

national competent authorities, or even market participants, when settling disagreements between national regulators.

Thirdly, preventive measures of market manipulation have been refined by Market Abuse Regulation, especially the whistle-blowing regime, reflecting international trends as well as similar measures in other crisis-era securities and markets measures.³⁹² Protections of blowers and procedure for receipt of reports and follow-up are specified in the new regime. Financial incentives may be also granted, which depends on the choice of national law.

And finally, the sanctions regime has been further harmonized in new market manipulation regime. On the one hand, rules concerning administrative sanction of market manipulation have been specified in Market Abuse Regulation. A minimum list of the types of measure and sanction available in Member States is provided, and pecuniary sanctions, which must be available, will be set the minimum quantum, in order to mitigate divergences in Member States. Further, publication of administrative sanctioning decisions, a “name and shame” mechanism, is designed to harness market discipline dynamics. And finally, the new market manipulation regime imposes reporting obligations on national competent authorities and ESMA to enhance monitoring and support convergences.³⁹³

On the other hand, criminal sanctions regime is introduced into the new market manipulation regulation. This is the first time that Article 83(2) TFEU is used as the legal basis for harmonizing criminal law, and it is also a pioneer to employ criminal law to ensure the effective implementation of EU polices. Directive on criminal sanctions for market abuse has made a minimum harmonisation to criminal sanctions of market manipulation, and Member States could choose retain or impose stricter rules.

³⁹² Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, pp. 761.

³⁹³ *Ibid*, pp. 764-765.

Directive on criminal sanctions for market abuse adopts the same application scope and exception with Market Abuse Regulation. Both nationals and legal persons are punishable by criminal sanctions for commitment of manipulative offences, which are serious and are committed with intent. So does inciting, aiding, or abetting offences aforementioned, and attempts to engage in market manipulation. In order to guarantee the dissuasive and deterrent effect of manipulation rules, a minimum maximum-term of imprisonment is provided for nature person liable for a breach. Legal persons must be subject to effective, proportionate, and dissuasive sanctions, which must include criminal (or non-criminal) fines.

Changes made in the Market Abuse Regulation will significant enhance the efficiency of supervision and enforcement of market manipulation prohibition in the EU. However, there still are some unsolved issues, such as, interpretation of “reasonable suspicion”, the criteria to decide “seriousness” and so on. Therefore, further improvements are needed to establish an EU uniform market manipulation regime.

Chapter 5 Market manipulation regulation and fundamental rights in the EU

Fundamental rights³⁹⁴ are formally recognized as part of the EU law by the Maastricht Treaty (1992). Protection of these rights has entered into a new phase since the adoption of the Lisbon Treaty. Article 6 of TEU is the central provision of fundamental rights. It clearly provides that fundamental rights come from three resources: the European Union Charter of Fundamental Rights and Freedoms (the Charter)³⁹⁵, national constitutional traditions and the European Convention for the Protection of Human Rights and Freedoms (ECHR)³⁹⁶. And EU law gives these fundamental rights (rather than the instruments in which they are contained) the same legal status as the Treaties.³⁹⁷

Fundamental rights have played a more and more important role in the regulation of the internal market through legislative harmonization.³⁹⁸ On the one hand, fundamental rights are directly binding upon the EU legislators, and compliance of which should be checked during the drafting process. This development is proved by the fact that older legislation did not contain any reference to fundamental rights or the general principles of Community law, while the more recent pieces of legislation, since 2005, contain recitals concerning the compliance with the Charter.³⁹⁹ On the other hand, it is also apparent from the settled case-law that fundamental rights form an integral part of the general principles of law whose observance the Court ensures, respect for human rights is a condition of the lawfulness of Union acts and measures implementing legislation should be compatible with those fundamental rights.⁴⁰⁰

Accordingly, Market Abuse Regulation, a secondary Union act, should respect the fundamental rights. The legislative measures setting out rules for market manipulation,

³⁹⁴ Fundamental rights and human rights are interchangeable in this paper.

³⁹⁵ TEU, Article 6(1).

³⁹⁶ TEU, Article 6(3).

³⁹⁷ Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law: cases and materials*, Cambridge University Press, 2010, the second edition, p.230.

³⁹⁸ Vasiliki Kosta, "Internal Market Legislation and the Private Law of the Member States: The Impact of Fundamental Rights", *European Review of Contract Law*, Volume 6, Issue 4, Pages 409–436, p.411.

³⁹⁹ Ibid.

⁴⁰⁰ CJEU, Case C-402/05 P and C-415/05, *P. Kadi and Al Barakaat International Foundation v. Council and Commission*, paragraph 283 and 284.

including sanctions should be in compliance with relevant fundamental rights.⁴⁰¹ And fundamental rights of particular relevance to the regulation of market manipulation include the freedom of expression; the right to private and family and the right to protect personal data; and the fundamental rights concerning justice.

However, fundamental rights are hardly ever of an absolute character, the application of which can be limited.⁴⁰² According to Article 52(1) of the Charter, limitation on the exercise of the rights and freedoms can be provided if, firstly, they are made by law and respect the essence of those rights and freedoms; and secondly, the limitations imposed are necessary and genuinely meet objectives of general interest recognized by the Union or the need to protect the rights and freedoms of others. Market Abuse Regulation aims to ensure and enhance the integrity of internal market and protect investors' interests (particularly fundamental right to property), but there are possibilities that some measures set out to regulate market manipulation in the Regulation may infringe fundamental rights when carried out. Therefore it is necessary to make an assessment of fundamental rights concerned and reach a balance between the general interest objective of ensuring market integrity and protection of fundamental rights.

5.1 The regulation of market manipulation and freedom of expression

Freedom of expression is one of the most important fundamental rights that guaranteed in the Union and in the Member States and as recognized pursuant to the Charter and to other relevant provisions. It means that everyone should have the freedom to hold opinions and to receive and impart information and ideas without interference by the public authority and regardless of frontiers.⁴⁰³ However, freedom of expression has a close relationship with market manipulation, the exercises of which might constitute market manipulation, and therefore need to be limited.

⁴⁰¹ Commission, Commission Staff Working Paper Impact Assessment, Brussels, 20.10.2011 SEC(2011) 1217 final.

⁴⁰² De Vries, Sybe A., "Balancing Fundamental Rights with Economic Freedoms According to the European Court of Justice" (January 31, 2013), *Utrecht Law Review*, Vol. 9, No. 1, p. 169-192, p.170.

⁴⁰³ The Charter, Article 11.

5.1.1 information-based manipulation and freedom of expression

Manipulation or attempted manipulation of financial instruments could be perpetrated by spreading false or misleading information through the media, including internet, newspaper and other means. The false or misleading information has a significant impact the prices of financial instruments, and could destroy the price discovery mechanism in the financial market. And such impact cannot be corrected in a relatively short period of time considering that information could spread through the market very quickly by high technologies.⁴⁰⁴

Information-based manipulation is particularly harmful, as it distorts the information which is the basis for the investors to rely on to make investment decisions, destroys the credit of issuers by misleading the public. Accordingly, free expression should be limited in financial market when a person know or ought to have known the information is false or misleading, in order to ensure the general interest objective of market integrity.

Certainly, there is an obvious borderline between disseminating false or misleading information with the freedom of expression, and this fundamental right never entails a person the right to spread false or misleading information. However, the harsh punishment imposed on misinformation pursuit to market manipulation regulation may seriously affect the right,⁴⁰⁵ because it is not always easy to make distinguish of the right and wrong in the world, and the fear of being punished for manipulation based on false or misleading information may be detrimental to the exercise of free speech.⁴⁰⁶

5.1.2 Market manipulation and journalist

Journalist, especially the one making financial comments, is a typical case concerning the relationship between market manipulation and freedom of expression. Articles concerning financial instruments, listed companies and related hidden resources published by

⁴⁰⁴ Market Abuse Regulation, Recital 47.

⁴⁰⁵ Jesper Lau Hansen, 'MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive' (2004), *European Business Law Review*, Issue 2, pp.206-207.

⁴⁰⁶ Ibid.

journalists, usually have a significant impact on the public when making investment decision.

According to current market manipulation regime, journalists are not except from the liability for manipulating market, as a result, they may be in fear of expressing their opinion concerning financial market, if market manipulation regulation covers a too wide scope and the sanctions are extremely serious. The solution is naturally to seek a compromise that on the one hand respects the very broad limits of free speech for the media, while on the other hand emphasis that market manipulation will apply to journalists who are in a conflict of interest by investing in the securities they comment on.⁴⁰⁷

Therefore, journalist is privileged to be regulated by national rules governing the freedom of press and freedom of expression in other media and the rules or codes governing the journalist profession, if these rules achieve similar effects as regulatory technical standards provided in the Market Abuse Regulation.⁴⁰⁸ At the same time, measures should be established to ensure that journalists objectively express their opinion, and to disclose their interests or indicate conflicts of interest concerning the financial instruments to which that information relates. Journalists might be considered as manipulators if (a) they, or persons closely associated with them, derive, directly or indirectly, an advantage or profits from his comments; or (b) the disclosure or the dissemination is made with the intention of misleading the market as to the supply of, demand for, or price of financial instruments.

5.1.3 Market manipulation and investment recommendations

Another typical case concerning the balance between right to freedom of expression and general interest of integrated market is investment recommendations or other information recommending or suggesting an investment strategy. Unlike journalists, investment

⁴⁰⁷ Jesper Lau Hansen, 'MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive' (2004), *European Business Law Review*, Issue 2, p.207

⁴⁰⁸ Market Abuse Regulation, Article 20(3).

recommendations or suggestions are usually published financial market professionals, such as independent analysts, investment firms, credit institutions, or natural persons working for them under a contract of employment or otherwise. They contain context in relation to one or several financial instruments, including the present or future value or price or the situation of their issuers. Such kind of information has significant influence on investors' investment judgments, in particular when the information is disclosed by famous financial market professionals.

Many market manipulation cases happen where orders to trade are given or transactions are undertaken by persons before the same persons or persons linked to them produce or disseminate investment recommendations which are erroneous, biased, or demonstrably influenced by material interest. As a result, in order to avoid the abuse of the right to freedom of expression, persons who produce or disseminate investment recommendations or other information that recommends or suggests an investment strategy in one or more financial instruments should be subject to strict transparent rules if they make trading of such instruments on their own accounts.

And given professional duties, investment advisors and similar persons should take reasonable care to ensure that information published is objectively presented. Further, they also should disclose their interests or indicate conflicts of interest concerning the financial instruments to which that information relates.⁴⁰⁹

5.2 Regulation of market manipulation and the right to privacy and protection of personal data

The rights to privacy and protection of personal data are recognized in Article 8 of ECHR⁴¹⁰, Article 7 and 8 of Charter of Fundamental Rights of The European Union⁴¹¹,

⁴⁰⁹ Market Abuse Regulation, Article 20(1)

⁴¹⁰ ECHR, Article 8: "1. Everyone has the right to respect for his private and family life, his home and his correspondence.

2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public

and in the general principles of Union law. These rights are also directly protected in Directive 95/46/EC, Regulation (EC) No 45/2001 and Directive 2002/58/EC.⁴¹²

5.2.1 Circumstances that might infringe the right to privacy and protection of personal data

The fundamental right to privacy and protection of personal data may be infringed in four circumstances according to the market manipulation regulation. The first case is regarding the exercise of investigatory and supervisory powers of competent authorities. A minimum set of powers is granted to competent authorities to facilitate the detection and sanctioning of market manipulation, in particular, the power to enter private premises to seize documents and data and the power to require telephone conversation, communication records or data traffic records, which are seen as the most important tools for the accomplishment of the investigatory and enforcement tasks of national regulators.⁴¹³

Nevertheless, the exercise of these powers is of high possibility to seriously interfere with the fundamental rights, notably the right to respect for private and family life and the right to the protection of personal data. It is confirmed by the case law of the Court that the access of the competent national authorities to the data constitutes a further interference

safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.”

⁴¹¹ Article 8 of the Charter: “1. Everyone has the right to the protection of personal data concerning him or her.

2. Such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified...”

⁴¹² Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications), Official Journal L 201 , 31/07/2002 P. 0037 – 0047; Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, Official Journal L 281 , 23/11/1995 P. 0031 – 0050;

And Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data, Official Journal L 008 , 12/01/2001 P. 0001 – 0022.

⁴¹³ CESR, “CESR’s response to the European Commission’s call for evidence on the review of Directive 2003/6/EC (Market Abuse Directive)”, June 2009, p. 4.

with the right to privacy and personal data protection recognized by Article 8 of the ECHR and Article 7 of the Charter.⁴¹⁴

The second situation is with regard to the whistleblowing regime. As analysed previously, whistleblowing is an efficient tool to detect market manipulation. However, the person who blows the whistle may face retaliation if his personal data is revealed to his employer or to the public. In addition, the right to privacy of the nature person who allegedly committed the infringement may also be infringed if his personal data is not well protected.

The third circumstance where the right to privacy and the right to protection of personal data is face of infringement is concerning the information-sharing system. In order to combat cross-border market manipulation, related information is shared among competent authorities, ESMA, and even supervisors in a third country. Personal data is inevitably included in the information exchanged. As a result, there is a possibility that personal data may be illegally disclosed or abused during or after the transfer.

And the last possible measure that may infringe the right to privacy and the right to protecting personal data is publication of decision. Disclosing the administrative or criminal sanctions for market manipulation is a “naming-and-shaming” strategy, which is also an effective way to deter market manipulation given reputational risk. However, according to Market Abuse Regulation, the context of publication concludes the identity of the person subject to the sanctioning decision, so there may be some situations that the disclosure of such data is disproportionate.

5.2.2 Balancing the fundamental right to privacy and general objective of the integrated market

Just like the right to freedom of expression, the right to privacy and protection of personal data are also not absolute. Such rights are subject to certain limitations when they are

⁴¹⁴ CJEU, Joined Cases C-293/12 and C-594/12 *Digital Rights Ireland and Seitlinger and Others*, paragraph 35 and the case-law cited.

necessary and genuinely meet general objective of integrated market in accordance with Article 52(1) of the Charter. It is also firm by the case-law of the Court that the Union rules do not preclude Member States from laying down an obligation to disclose personal data for administrative proceedings, in this case for supervising or investigating market manipulation, provided that such an obligation is subject to the principle of proportionality test and the necessity of reaching a fair balance between different fundamental rights and freedoms.⁴¹⁵

In relation to determine the proportionality test and fair balance, no general rules are provided in the Market Abuse Regulation, so it is currently depending on the case law of Court.⁴¹⁶ However, some measures are set out in the Market Abuse Regulation that may indicate whether the behaviour taken to limit the right of privacy and protection of data is proportionate or not.

5.2.2.1 The proportionality test and powers of competent authorities

In terms of the exercise of the powers to acquire data traffic records from telecommunications operator, it could be considered as proportionate if: a) a reasonable suspicion of market manipulation must exist; b) the data required is provided only to the competent authorities responsible for the manipulative investigation and serve the purpose thereto; c) the data required is limited to what is strictly necessary to carry out the investigation and is deleted when the investigation is closed without further action.⁴¹⁷

In terms of the power to enter the private premises to seize documents and data, safeguards that ensure the proportionality are similar to that of the power to acquire data traffic records, including: a) a reasonable suspicion of the infringement of market manipulation

⁴¹⁵ See Netherlands Authority for the Financial Markets (AFM), “Responses of the Netherlands Authority for the Financial Markets (AFM), and on behalf of the Dutch Ministry of Finance, to the call for evidence of the European Commission’s services regarding the review of the MAD”, 11 June 2009, p.5. Also see Tom Van Dyck, “The Review of the Market Abuse Regime in Europe”, (February 12, 2010), p.8. Available at [SSRN: http://ssrn.com/abstract=1558342](http://ssrn.com/abstract=1558342).

⁴¹⁶ CJEU, Case C-275/06, *Promusicae v Telefonica de España*, paragraph 68, Case C-131/12 *Google Spain and Google*, paragraph 81, and Joined Cases C-293/12 and C-594/12.

⁴¹⁷ Commission, Commission Working Staff Paper Impact Assessment, SEC (2011) 1217 final, p. 153; and the Market Abuse Regulation, recital 65 and 66, Article 23(2)(h).

and of the removal or destruction of critical evidences; b) prior judicial authorization should be acquired if needed according to national law; and c) deletion of the related information when the investigation is totally finished. In addition, these powers should be carried out in accordance with national law, and exercised to the extent necessary for the proper investigation of serious cases where there are no equivalent means for effectively achieving the same results.⁴¹⁸

5.2.2.2 The proportionality test and processing of personal data

Limitation to the right to privacy and protection of personal data is proportionate if the personal data processed is accurate, adequate and the use of such data is solely for the purpose of investigating market manipulation by competent authorities. In addition, the personal data access should be limited to the time necessary to conduct market manipulation investigation, and it shall be retained for a maximum period of five years.⁴¹⁹

Further, the processing of personal data should be complied with the national laws, regulations or administrative provisions transposing Directive 95/46/EC and Regulation (EC) No 45/2001, and the proportionality test should be based on a case-by-case basis.

5.2.2.3 *The proportionality test and whistle-blowing*

Measure provided is proportionate if it can ensure protection of whistle blowers, including protecting private and personal data. Meanwhile, the personal and private data of suspects under investigation of market abuse as a result of whistle blowing should also be protected by the competent authorities. If the investigation fails to detect market abuse, the data provided by the whistle blower should be deleted by the competent authorities. To this end, competent authorities should assess if there are reasonable grounds to suspect market abuse.

⁴¹⁸ Market Abuse Regulation, recital 66.

⁴¹⁹ Market Abuse Regulation, Article 28.

5.3 Regulation of market manipulation and the fundamental rights to justice

In order to reduce regulatory arbitrage and support effective enforcement in the EU financial markets, the sanctioning regime of market manipulation has been harmonised and both administrative and criminal sanctions can be imposed on the offences. These sanctions are critical to deter and punish market misconducts, to protect investor confidence for the financial markets and to preserve the integrity of the internal market.

However, sanctions and measures would certainly interfere with, on the one hand, the substantive fundamental rights, such as the property right or the right to conduct business; and the procedural rights on the other hand. Therefore, it is unlawful for a public authority, including the supervisory authorities, courts or tribunals, to act in a way which is incompatible with fundamental rights unless they could not have acted differently as a result of existing legislation.⁴²⁰ And sanctions for market manipulation, which might limit the exercise of fundamental rights, are legal only if they serve the justified objective and comply with the proportionality test.

This section focuses on the fundamental rights of particular concerning market manipulation regulation, which cover those provided under Chapter VI Justice of the Charter and Article 6 and 7 of ECHR: the right to an effective remedy and to a fair trial; the presumption of innocence and right of defence; the principles of legality and proportionality of criminal offences and penalties; and the right not to be tried or punished twice in criminal proceedings for the same offence⁴²¹.

5.3.1 Administrative sanctions and the fundamental rights to justice

Although serious misconduct subject to the Market Abuse Regulation is similar in nature to the criminal offences of market manipulation, the administrative sanctions imposed on

⁴²⁰ Thomas A.G. Beazley, "Holding the Balance: Effective Enforcement, Procedural Fairness and Human Rights", E. Ferran, C. A. E. Goodhart (eds), *Regulating Financial Services and Markets in the 21st Century*, Hart Publishing Co., 2001, pp.115-116.

⁴²¹ The Charter, Article 47-50.

by competent authorities are not criminal.⁴²² Compared with the criminal procedure, the market manipulation proceeding has a lower threshold of proof, and does not result in a criminal record, moral opprobrium that attaches to criminal convictions, or the imprisonment of the defendant. Despite that market manipulation regime is not accepted as criminal in nature, and it is the national competent authority rather than the court or tribunal to make sanctioning decisions, protections provided in the Charter (Chapter vi Justice) and ECHR (Article 6 and 7) should still be respected in proceedings for the imposition of a penalty for market manipulation.⁴²³

The right to an effective remedy and fair trial, the right to presumption of innocence and right of defence are of particular concern when a person is under the proceeding for administrative sanction. Some measures stipulated in the Market Abuse Regulation contribute to the protection of these fundamental rights.

In the first place, the Market Regulation introduces uniform rules for administrative sanctions and measures, which aims to ensure that the comparable offence of market manipulation would be subject to comparable type and level of administrative sanction across the EU.⁴²⁴ In addition, common minimum rules set out in the regulation to efficient remedy provided for people who suffer lost because of market manipulation. The rules would ensure that administrative sanctions are higher than the potential profits from market abuse and disgorgement of profits.⁴²⁵ Particularly in the case of monetary penalties, administrative fines imposed under the regulation are paid back to the financial services industry, thus compensating, albeit indirectly, those who suffer the increased costs

⁴²² Daniel F. Waters and Martyn Hopper, "Regulatory Discipline and the European Convention on Human Rights", in E. Ferran, C. A. E. Goodhart (eds), *Regulating Financial Services and Markets in the 21st Century*, Hart Publishing Co., 2001, p.104. Also see Mark Jones and Peter Johnstone, "Expectations of Privacy and Market Abuse – Support for the Financial Services and Market Act and the Canadian Approach", *Journal of Financial Crime*, Oct 2002, 10, 2, p.121.

⁴²³ Daniel F. Waters and Martyn Hopper, "Regulatory Discipline and the European Convention on Human Rights", in E. Ferran, C. A. E. Goodhart (eds), *Regulating Financial Services and Markets in the 21st Century*, Hart Publishing Co., 2001, p. 110.

⁴²⁴ Commission, Commission Staff Working Paper Impact Assessment, Brussels, 20.10.2011 SEC(2011) 1217 final.

⁴²⁵ Ibid

imposed on market participants by market manipulation.⁴²⁶ The amount of the fines is determined with consideration of the gravity and duration of the manipulative offence, the responsibility of the perpetrator, the importance of the profits gained or losses avoided, and other elements provided in the regulation. Furthermore, a minimum maximum the administrative pecuniary sanction, in respect of both natural and legal person, is set out in order to guarantee the fine is sufficient and deterrent and to avoid divergent treatments in different Member States. All these measures would contribute to the right to an efficient remedy and fair trial.

In the second place, the right of presumption of innocence and the right of defence are also respected and protected in the administrative proceedings. Before making administrative sanction decisions, competent authorities should provide sufficient evidence to prove that a person has involved in a manipulative behaviour or an attempted manipulative behaviour, despite that the burden of proof does not follow the criminal level but civil one. The person allegedly to commit such misconduct shall also have the right to defend. Even though Market Abuse Regulation does not provide explicitly rules, Member States are required to have the law to ensure that these fundamental rights are respected and observed.

A typical example is relating to whistleblowing regime. When suspicious orders and transactions that may constitute market manipulation or attempted market manipulation are reported by a company insider, the person alleged should be entitled the fundamental rights to justice. Firstly, competent authorities should make an assessment if there are reasonable grounds to suspect market manipulation before they carry out their investigation.⁴²⁷ At the same time, the nature personal who allegedly committed the infringement should be protected at all stages of the procedure without prejudice to

⁴²⁶ Daniel F. Waters and Martyn Hopper, "Regulatory Discipline and the European Convention on Human Rights", p. 110.

⁴²⁷ Commission, Commission Staff Working Paper Impact Assessment, Brussels, 20.10.2011 SEC(2011) 1217 final, pp.156-157.

disclosure of information being required by national law in the context of investigations or subsequent judicial proceedings.⁴²⁸

5.3.2 Criminal sanctions and the fundamental rights to justice

Given the harsh punishment, criminal sanctions are considered to have a strong deterrent effect on potential market misconducts. However, criminal investigations and sanctions compromise intrusive rules, which have a significant impact on individual rights, which may result in deprivation of liberty and stigma effect. Therefore, it is very important that the imposition of criminal sanctions and measures is in accordance with the Charter and ECHR, which provide important limits for EU action in this field.⁴²⁹

In general, Directive on criminal sanctions for market abuse respects the fundamental rights and observes the principles recognized in the Charter, especially the right to an effective remedy and the right to a fair trial, the presumption of innocence and right of defence, the principles of legality and proportionality of criminal offences and penalties, and the right not to be tried or punished twice in criminal proceedings for the same offence.⁴³⁰ To be specific, firstly, an approximation of national criminal law with regard to market manipulation is made in order to reinforce uniform enforcement of market manipulation rules and to increase the deterrent effect.

Secondly, criminal sanctions and measures are only subject to serious offences of market manipulation or attempted market manipulation committed with intent. Such arrangement would, on the one hand, guarantee that the person who causes the most serious damage to the financial market and investors is punished with the harshest type and level of sanctions or measures; and on the other hand, avoid wasting time and legal resources to cases of slight influences.

⁴²⁸ Market Abuse Regulation, Article 32(1)(b)

⁴²⁹ Commission Communication, “Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law”, Brussels, 20.9.2011, COM(2011) 573 final.

⁴³⁰ Directive on criminal sanctions for market abuse, recital 27.

And finally, a minimum requirement regarding the type and level of criminal sanction would help to make comparable sanction to offences by comparable punishment at EU level, in case that the perpetrator takes advantage of the lenient jurisdiction. As stated in the recital of Directive on criminal sanctions for market abuse, imposition of criminal sanction should be appropriate, taking account the profits made or losses avoided as well as the damage resulting from the offence to other persons and to the functioning of markets or wider economy.⁴³¹

In addition, Directive on criminal sanctions for market abuse does not preclude Member States from imposing both administrative penalties and criminal sanctions for market manipulation at the same time. And the possibility and/or the level of a criminal sanction, which may subsequently be imposed, do not affect the assessment in relation to the effect, proportionality and deterrence of an administrative sanction.⁴³² Since punishments imposed by the competent authorities are not criminal in nature, no breach is made concerning the right not to be tried or punished twice in criminal proceedings for the same offence.

Furthermore, except from the obligations under Union law on procedural right in criminal proceedings, Member States are also obliged to ensure the procedure rights of suspected or accused person in criminal proceeding in their national laws. Since the Directive only makes a minimum harmonization on certain aspects of criminal sanctions for market manipulation, it is mainly the obligation of Member States to provide higher level rules to protect these fundamental rights.

It is fair to conclude that these measures adopted in the Directive on criminal sanctions for market abuse contribute to the protection of the fundamental rights to justice. Since criminal sanctions and measures are big threats to the fundamental rights considering their severity and stigma effects, the impositions should be stick to the proportionality principle.

⁴³¹ Directive on criminal sanctions for market abuse, recital 24

⁴³² CJEU, Case C-45/08, *Spector Photo Group and Van Raemdonck*, paragraph 74-77.

If criminal law measures are used to support the enforcement of EU policies, such as ensuring and promoting market integrity in this case, they must always remain a measure of last resort. So an analyse whether measures other than criminal law measures could not sufficiently ensure the policy implementation and whether criminal law could address the problems more effectively needs to be made.⁴³³ In essence, whether limitations for fundamental rights to justice could be justified or not is a question about how to make a balance between effective enforcement of market manipulation rules and procedural fairness and fundamental rights.

Conclusion of Chapter 5

Fundamental rights are given the same legal status with the Treaties by EU law. They have played an increasing important role in the regulation of the internal market through legislative harmonization.⁴³⁴ Fundamental rights are not only directly binding upon the EU legislators, the compliance of which should be checked during the drafting process, but also form an integral part of the general principles of law whose observance the Court ensures. Therefore, Market Abuse Regulation and Directive on criminal sanctions for market manipulation, as secondary Union acts, should respect the fundamental rights.

Meanwhile, the application of fundamental rights can be limited if limitations, which are made by law and respect the essence of those rights and freedoms, are necessary and genuinely meet objectives of general interest recognized by the Union or the need to protect the rights and freedoms of others. Regulation of market manipulation, aiming to ensure and enhance the integrity of internal market and to protect investors' interests (particularly fundamental right to property), satisfies such conditions. Accordingly, an assessment relating to balancing the prohibition of market manipulation and protection of fundamental rights should be made in practice.

⁴³³ Commission, Commission Staff Working Paper Impact Assessment, Brussels, 20.10.2011 SEC(2011) 1217 final.

⁴³⁴ Vasiliki Kosta, "Internal Market Legislation and the Private Law of the Member States: The Impact of Fundamental Rights", *European Review of Contract Law*, Volume 6, Issue 4, Pages 409–436, p.411.

Three types of fundamental rights are of particular relevance to the market manipulation prohibition, including freedom of expression; the right to private and family and the right to protect personal data; and the fundamental rights concerning justice. Firstly, journalists and investment advisors will be affected by the prohibition of market manipulation because of their professions. In order to avoid abusive punishment, the market manipulation regime sets out special conditions of determining related manipulative behaviours.

Secondly, some powers of competent authorities are very aggressive, such as the right to enter into private premises in order to seize documents and other data, to require telephone and data traffic from telecommunications operators and investment firms. The rights to privacy and protection of personal data are easily breached by these powers, so Market Abuse Regulation sets out conditions of their exercises to avoid abuses, while national law plays a more important role in their protection.

And finally, fundamental rights concerning justice should be paid more attention with the further harmonisation of sanctioning regime of market manipulation in the EU. Some measures that ensure the procedural rights of suspected manipulators during administrative sanctions have been provided by Market Abuse Regulation. While Directive on criminal sanctions for market abuse requires that Member States should guarantee procedural rights of suspected or accused persons in criminal proceedings.

In general, the new EU market manipulation regime has made big improvements concerning the balance between prohibition of market manipulation and protection of fundamental rights. And the success will highly depend on Member States, who are obliged to ensure proper measures are provided in the national law.

Chapter 6 Regulating market manipulation in China: relevance of the EU experience⁴³⁵

Market manipulation has been one of the most serious issues in the Chinese securities market since its establishment. However, the regulation of market manipulation in China is far from mature, which cannot efficiently prevent this type of illegal activities. On the contrary, EU market manipulation regime has been proved to be effective in combating market manipulation, in particular after the adoption of new regulatory package, many tough issues, such as detection, investigation and supervision of cross-border and cross-markets manipulation, will be further refined. As the Chinese securities market is getting more fragment and international, many issues that exist in the EU financial market have showed in the China while the relating regulation is still blank. Therefore, studying the EU regulatory experiences concerning market manipulation will be useful for refining the Chinese market manipulation regime.

6.1 A brief review of the development of Chinese securities market

A general picture of the developing history of securities market in China is the background knowledge, which helps us to get a better understand of the Chinese market manipulation issue. While the People's Republic of China was founded in the 1949, its securities market began to establish after the Economic Reform in 1979.⁴³⁶ It was not until December 1990 that China established its two stock exchanges, Shanghai Stock Exchange and Shenzhen Stock Exchange. Although the starting point of Chinese securities market is very late compared with other ones in most of the developed countries, it has developed extremely fast in the past 30 years. At the end of September 2014, Shanghai Stock Exchange and Shenzhen Stock Exchange's worldwide ranking are 7th and 9th respectively according to

⁴³⁵ The securities market and its legal framework analysed in this thesis only mean that in the mainland of China, not including Hong Kong, Macao, and Taiwan district.

⁴³⁶ From the establishment of the People's Republic of China in the 1949 to 1978, China was of a centrally planned economy. It was until 1978 that market was incorporated into the planned economy. And the market after the reform is commonly known as socialist market economy.

market capitalisation.⁴³⁷ Besides, China is devoting to develop multi-level capital market system, aiming to satisfy the capital needs from various parties, especially for small and media enterprises.⁴³⁸

In order to guarantee the sound functioning of securities market and to protect investors, a set of legislations has been adopted and amended since the market's establishment. Administrative regulations of the State Council constituted the major legal resources for regulating the securities market before the adoption of *Law of the People's Republic of China on Securities* in 1998 (hereinafter "the 1998 Securities Law").⁴³⁹ The 1998 Securities Law is the "constitution law" for the securities market, which not only affirms the legal status of securities market in China, but also provides basic rules for the offering and trading of securities as well as the liability regime for wrong-doings in the securities market. With the further development of economy and financial system reform in China, the 1998 Securities Law were amended with significant changes in 2005 and a package of relative administrative regulations were published at the same, together of which a complete legal system for regulating securities market is generally created.⁴⁴⁰

Further, a single centralized supervisory system for the securities market has been established with more than 20 years' effort. Initially, two dedicated regulators, the Securities Committee of the State Council (SCSC) and the China Securities Regulatory Commission (CSRC)⁴⁴¹, were instituted to oversee the nationwide securities market in

⁴³⁷ This statistics is provided by the Securities and Futures Commission (Hong Kong), available at <http://www.sfc.hk/web/EN/published-resources/market-and-industry-statistics/statistics-by-topics/>, last visit on 18 December 2014.

⁴³⁸ China Securities Regulatory Commission, *China Capital Markets Development Report*, China Financial Publishing House, 2008, p. 134.

⁴³⁹ The main administrative regulations include *Tentative Regulation on the Administration of the Issuing and Trading of Shares* (1993), *Implementing Rules on Information Disclosure by Public Share Offering Companies* (1993), and *Interim Measures for the Prohibition of Securities Fraud* (1993, repealed by the Securities Law (2005)).

⁴⁴⁰ China Securities Regulatory Commission, *China Capital Markets Development Report*, China Financial Publishing House, 2008, pp. 74-78.

⁴⁴¹ "SCSC was responsible to draft relevant laws, rules and regulations for securities market, develop long-term strategies, deliver guidance and coordinate among central and local governments, conduct supervision and inspection of market activities. The CSRC reported to SCSC and was responsible for developing market rules and regulations, supervising the securities firms, especially their proprietary trading activities, and listed companies as well as their issuance and selling of securities to the public, and

1992, which was a remarkable milestone as from then on China's securities market started to align for the first time under a single centralized regulatory framework.⁴⁴² Meanwhile, People's Bank of China (PBC), the central bank, shared part of the powers concerning the regulation of securities companies. It was at the end of 1998 CSRC replaced SCSC and took over PBC's power with regard to securities companies' regulation, becoming the single independent supervisor for the entire securities market in China.

In the past 20 years, CSRC has played a crucial role in ensuring the market's sound and order functioning and in protecting investors. In particular, an inspection department targeting illegal behaviours in the securities and futures market was instituted by the CSRC in 1995. Seven years later, another specific inspection department for investigating insider dealing and market manipulation was established inside CSRC. Then in 2004, CSRC instituted regional supervisory agencies in each province, and created cooperation mechanism with the local government, which greatly increased the efficiency of enforcement. Furthermore, CSRC has also engaged to develop international supervisory cooperation with other worldwide supervisors, enabling it to exchange information or provide helps for cross-broad investigations.⁴⁴³

Despite significant achievement that has made, the Chinese securities market is still quite young and immature. There are many critical issues requiring further efforts to resolve in order to keep the market from collapse, including the significant influence of government

overseeing the overseas listing of domestic companies." See China Securities Regulatory Commission, *China Capital Markets Development Report*, China Financial Publishing House, 2008, p. 164.

⁴⁴² In May 1992, Securities Supervision Office of People's Bank China (PBC) was established, which is the first institution that exercised centralized supervision over China's securities market. And two months later in that year, the State Council instituted the Joint Staff Meeting for Securities Supervision to oversee the securities market on its behalf. But it was replaced by the SCSC and CSRC shortly after the "August 10 Incident".

⁴⁴³ CSRC has signed 37 bilateral cooperation memorandums with 33 supervisory authorities of securities market in different countries and districts at the end of 2007. See China Securities Regulatory Commission, *China Capital Markets Development Report*, China Financial Publishing House, 2008, p. 187.

policy to the securities market, the problem of ownership structure⁴⁴⁴, inadequate protection of minor shareholders, and inefficient enforcement.⁴⁴⁵

Given the incomplete regulation system and credit mechanism, market manipulation has been a big threat to the securities market since its establishment. It is commonly accepted that the development history of the securities market in China is also a developing history of combating market manipulation.⁴⁴⁶ Unfortunately, no effective system has been founded concerning the regulation and supervision for market manipulation until now. Furthermore, the globalisation of securities market provides more opportunities for cross-broad market manipulation, and will worsen the current situation of the Chinese securities market.

6.2 Market manipulation and its main features in the Chinese securities market

Market manipulation is closely associated with the Chinese securities market since its establishment in the late 1970s. It is one of the primary threats to the market integrity and investors' interest. The history of the Chinese securities market is also the history of market manipulation.⁴⁴⁷ Market manipulation cases, not only have an impressive number, but also have a significant serious influence to the securities market. With the development of securities market and related legislation, market manipulation shows different features in different phases of the securities market's development.

6.2.1 Market manipulation in different developing phase of securities market

6.2.1.1 Market manipulation before 1990

⁴⁴⁴ Not all shares in the Chinese securities market are tradable, such as legal person shares. "The most obvious impact of classification between tradable and non-tradable shares is the limited free float available, which made the domestic market extremely illiquid, volatile, and thus prone to market manipulation and insider trading." See Flora Xiao Huang and Horace Yeung, *Chinese Companies and the Hong Kong Stock Market*, published by Routledge, 2014, p.39.

⁴⁴⁵ See Flora Xiao Huang and Horace Yeung, *Chinese Companies and the Hong Kong Stock Market*, published by Routledge, 2014, pp. 40-42.

⁴⁴⁶ Dong An-Sheng, Zhang Xiao-Min, and Liu Shen, "Supervision of the Behavior of Manipulating the Market in China: Actuality, Reflection and Future", *The Jurists*, 2005, 1(1), pp. 123-127.

⁴⁴⁷ Cheng Xiao, "Study on the Market Manipulation and its Civil Liability", the *Science of Legal*, Issue 4(2001).

Before 1990, the securities market in China was a paradise for manipulators. On the one hand, the price of a stock was easily influenced. Because at that time there was no stock exchange, so few stocks were offered, the transitions of which were made either in the over-the-counter market or in private. As a result, the small trading volume led to higher possibility of manipulation. On the other hand, as no legislation prohibiting market manipulation was adopted, it did not raise any cost for a person to perpetrate such behaviours.

Since the stock exchanges had not been established at that time, the typical form of market manipulation was speculating the issue prices of a stock, which is a rare case in other mature securities market.⁴⁴⁸ Many manipulators with capital advantages dumped the shares to make illegal profits shortly after pushing up the issue price of a stock at an abnormal level. Besides, the government could be said to be the biggest manipulator, because it had decisive power to approve the issue of a security and its issuing price. Furthermore, given that information disclosure system was not established and the majority investors were retail investors, who did not have much professional knowledge, information-based manipulation constituted another typical type of manipulation during that period.

6.2.1.2 Market manipulation between 1990 and 2004

In wake of the establishment of two stock exchanges at the end of 1990, securities trading were greatly increasing. Unfortunately, so did the number of market manipulation cases. Although a uniform regulatory and supervisory framework has been gradually established at the end of 1998, it is not mature enough to make an effective deterrence or sanction of manipulative activities. A series of manipulative cases with significant influence has been investigated and reported to the public, which cover the main forms of market manipulation. For example, the cases of *Yi'an Keji* and *Zhongke Chuangye* are model

⁴⁴⁸ Geng Jian-xin, and Zhou Fang, "Positive Analysis: Reform of Marketing Issuing Price", *Economic Theory and Business Management*, 2002, Issue 11, pp. 34-39.

cases of wash sale and successive trading, *Su Sanshan* case represents manipulation employing false information, and “327 treasury bond future” case is a classic example of improper matched orders.⁴⁴⁹

In general, most of the manipulators from 1994 to 2004 are a group of people, popular known as *zhuangjia* (arch manipulators), who specialize in making illegal profits by driving up the prices of certain stocks before getting out and leaving small investors holding the bag.⁴⁵⁰ Therefore, this period is also called “dealer-manipulated share time”.⁴⁵¹

6.2.1.3 Market manipulation after 2004

Given the serious damages made by market manipulation in the securities market, more effects are made by legislators and supervisors in order to prevent market manipulation and to enhance investors’ confidence in the securities market. The level of administrative and criminal sanctions for market manipulation was increased after the amendment of the Securities Law (2005) and Criminal Law (2006).⁴⁵² And in terms of enforcement, more inspectors are established nationwide by CSRC in order to have a better detection of market manipulation. From 2008 to August 2014, 150 cases to be suspected of market manipulation were investigated by CSRC, of which 41 cases had been imposed administrative sanction and 7 cases were responsible for criminal punishment.⁴⁵³

As the regulation and supervision systems become more efficient, methods employed by manipulators also evolve at the same time. With the wide use of computers and the internet in securities transactions, there was a burst of manipulation cases based on false or misleading information around 2008, such as case of *Wang Jianzhong* (scalping), *Wuhan*

⁴⁴⁹ Cen Jianping, “Study on the market manipulation”, *He Bei Law Journal*, 1999 Issue 5.

⁴⁵⁰ Ding Chen, *Corporate Governance, Enforcement and Financial Development: the Chinese Experience*, Edward Elgar Publishing, 2013, p. 125.

⁴⁵¹ Special Report on “Dealer-Manipulated Share”, available at http://news.xinhuanet.com/fortune/2014-11/24/c_1113375890.htm, last visited on 04 Feb 2015.

⁴⁵² For example, the highest level of fixed-term imprisonment for manipulators has been increased from 5 years to 10 years.

⁴⁵³ CSRC Release on the enforcement information of market manipulation in recent years, published on 22, August 2014, available at http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201408/t20140822_259482.html, last visit on 04 Feb 2015.

Xin Delan Investment Consultants Ltd (scalping), *Leading Brother (Daitou Dage)* 777 (false and misleading information). Compared with manipulation before 2004, the majority cases have become more complex and harder to detect in recent years. They no longer just depend on capital advantages, but employ a combination of several methods (capital, information, dominating position, and so on).⁴⁵⁴ As a result, the phase after 2004 is popular known as “post dealer-manipulated shares time”.

6.2.2 Main features of market manipulation in the China’s securities market

From the evolvement of the securities market and manipulative cases in practice, certain features of market manipulation in the China’s securities market could be concluded.

6.2.2.1 Manipulation of Chinese character: dealer-manipulated shares

Dealer-manipulated shares have a long history in the Chinese securities market, and they are still active in recent years. Since the establishment of the securities market, market manipulation has never been out of sight. Prior to the launch of split-share structure reform⁴⁵⁵ in 2005, nearly every stock in the secondary market was under speculation, and the trading price and volume were significantly influenced by the arch manipulators who were in possession of large capital.⁴⁵⁶ While the regulatory and supervisory framework has been improved after 2005, the number of manipulation cases is still quite surprising. The Chinese securities market is considered as a giant platform for manipulation, as investors try to get profits from speculation rather than share dividend.⁴⁵⁷

⁴⁵⁴ Xinhua Net Special Report, “The Phantom of Dealer-manipulated Shares—Investigation on Market Manipulation in the Chinese Securities Market”, available at http://news.xinhuanet.com/fortune/2014-11/23/c_1113364367.htm, last visited on 04 Feb 2015.

⁴⁵⁵ The split-share structure was a legacy of China’s initial share issue privatization, in which state-owned enterprises went public to issue minority tradable shares to institutional and individual investors. The Split-Share Structure Reform granted legitimate trading rights to the state-owned shares of listed state-owned enterprises, opening up the gate to China’s secondary privatization. Li Liao, Bibo Liu, Hao Wang, “China’s secondary privatization: Perspectives from the Split-Share Structure Reform”, *Journal of Financial Economics*, Volume 113, Issue 3, September 2014, pp. 500–518.

⁴⁵⁶ Special Report on “Dealer-Manipulated Share”, available at http://news.xinhuanet.com/fortune/2014-11/24/c_1113375890.htm, last visited on 04 Feb 2015.

⁴⁵⁷ Jing Changyu, “Research on the Regulation of Securities Market Manipulation”, doctor thesis, Ji Lin University, 2012, Ji Lin, China.

6.2.2.2 Manipulation by more complex and sophisticated methods

The forms of market manipulation become more complex and harder to detection in China. Comparatively, the main forms of market manipulation in 10 years ago were wash sale, improper matched orders and successive trading, which were usually made by one single or a few institution or nature person with a large amount of funds or shareholdings. For example, in the case of *Yi'an Keji* (2001), the shares were speculated by four investment advisory companies, who speculated the stock price increasing from 26 RMB to more than 100 RMB only in 70 trading days, and made illegal profit of 449 million RMB (about 59 million Euros).⁴⁵⁸

However, such easily detected kinds of manipulations are getting less and less with CSRC becomes more and more decisive and efficient. A number of more complex and new forms of market manipulation come into sight. On the one hand, with the wide use of internet and computers, fictitious orders, scalping and other manipulative methods are created and generate a number of derivative forms in a very short time. Besides, speculators now do not use a single method, but employing a combination to affect the trading prices or volumes of shares.

On the other hand, market manipulation is usually accomplished by a relatively larger number of people than before, and the connection between manipulators is harder to prove.⁴⁵⁹ For example, the accounts used for manipulation used to belong to the manipulator himself or his relatives⁷, but now the accounts used have no connections and are spread widely. Furthermore, market manipulation cross the future markets or commodity markets is also being detected. Such emerging kind of market manipulation has a larger influence to the financial market and it is also very difficult to supervise.⁴⁶⁰

⁴⁵⁸ CSRC Administrative Sanction Decision No.7 (2001)

⁴⁵⁹ For example, in the manipulation case of Li Jiewei, the manipulator used 65 non-related accounts to manipulate the target stock. See CSRC Administrative Sanction Decision (Xin Yatai, Li Jiewei), No. 13 (2012).

⁴⁶⁰ CSRC Release on the enforcement information of market manipulation in recent years, published on 22 August 2014, available at

6.2.2.3 Dominant position of information-based manipulation

Manipulation by disseminating false or misleading information becomes the dominate type of market manipulation in recent years. Information spreads much wider and faster in the securities market with the development of communication technologies. Blogs, bulletin board service (BBS for short), and other social networking platform are the modern and hot way for disseminating and receiving information, in particular for retail investors who are easier to be influenced.

According to the information disseminators, two main categories of manipulators exist. One is led by manipulative investors, who have bought certain shares before they spread beneficial information through BBS, blogs and other social networking platform to induce a great quantity of retail investors to purchase these shares, and they will dump these shares when the price gets higher. The shares targeted in this form of manipulation are always of small trading volume and the perpetrators are usually nature person rather than institutions.⁴⁶¹

The other type of manipulator is predominated by the listed company and/or its major shareholders or managers. In order to benefit the leading shareholders to sell down their stakes, a list company may control the time and contents of the information disclosed, or the managers may conspire with outsiders to make up positive events of the listed company.

In general, as the development of the securities market and its regulation, market manipulation also evolves. From the cases investigated by CSRC, it could conclude that both the strategies and methods used by manipulators are becoming more complicated. More manipulation cases are made in a short term employing several forms of manipulation at the same time, such as wash sale, fictitious orders and information-based

http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201408/t20140822_259482.html, last visit on 04 Feb 2015.

⁴⁶¹ Typical cases include Wang Jianzhong, Xin Delan (Wu Han), Daitou Da Ge, and so on.

manipulation; the fund used to speculate the target stocks is extremely large, and the amount of transition can accumulate to millions or even billions of Euros; and the cross-border or cross-markets manipulation is emerging in the Chinese securities, which deserves more attention in both regulation and supervision aspect.⁴⁶²

6.3 An analysis of market manipulation regime in China

As a result of the Culture Revolution from 1966 to 1976, the whole legal framework of the securities market in China was destroyed. Therefore, the current securities legal framework is built from zero with more than 30 years' efforts, which is based on the special Chinese special economic structure and draws many experiences from the US, Germany and Japan. However, the securities legal framework, in particular the part concerning market manipulation, is still immature and inefficient.

6.3.1 Legislation history and legal resources of market manipulation regulation in China

6.3.1.1 Market manipulation regulation before 1998

Market manipulation was free of regulation in the first 10 years after the establishment of the securities market. It is firstly prohibited in a regional administrative regulation issued by Shanghai municipal government in November 1990, in which improper matched orders, successive trading, manipulation based on information, buy-back programmes, and manipulation employing other types of methods were clearly banned.⁴⁶³ Soon after that similar rules were provided in *Shenzhen Interim Provisions on Management of the Trading of Stocks*, another regional regulation. It was until 22 April 1993 that the State Council adopted the first nationwide regulation, *Interim Provisions on the Administration of the Issuing and Trading of Stocks*, which provides a nationwide prohibition of market

⁴⁶² CSRC Release on the enforcement information of market manipulation in recent years, published on 22 August 2014, available at http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201408/t20140822_259482.html, last visit on 04 Feb 2015.

⁴⁶³ Shanghai Provisions on the Management of Trading of Stocks, Article 39.

manipulation. This regulation worked as the “constitution law” of the securities market for more than 5 years before the entering into force of the Securities Law in 1 July 1999.

The *Interim Provisions on the Administration of the Issuing and Trading of Stocks* stipulates several forms of manipulation subject to administrative punishment, including affecting the offering or trading of stocks by conspiracy, fund advantage or disseminating rumours and so on, improper matched orders, and short selling. With regard to the sanctioning regime, administrative liability is the major form of punishment. While civil and criminal liabilities are both mentioned in the regulation, they are not applicable considering the provision concerned are not accurate and clear, as well as short of implementing rules.⁴⁶⁴

Besides, given illegal securities behaviours were quite active at that time, a specific regulation prohibiting securities frauds was published by the State Council on 2 September 1993, *Interim Provision of the Prohibition of Securities Frauds of the State Council* (1993), which provided more detailed rules with regard to the definition and types of market manipulation.⁴⁶⁵ Then in 1996, CSRC issued an announcement to make a particular ban of manipulative behaviours in the securities market, adding some new measures used by manipulators to induce investors to make investment decision.⁴⁶⁶

6.3.2.2 Market manipulation regulation under the 1998 Securities Law

⁴⁶⁴ Cheng Xiao, “Study on the Market Manipulation and its Civil Liability”, *Science of Legal*, Issue 4(2001), p.91.

⁴⁶⁵ The provision concerning market manipulation included Article 7 and 8, and this regulation was repealed.

⁴⁶⁶ *The Announcement on the Prohibition of Market Manipulation* published by CSRC is a soft law. In this announcement, a general definition of market manipulation was provided, which describe as “*any institution or nature person is forbidden to manipulate the prices of instruments in the securities market through capital, information or other types of advantages, and induce the investors to make investment decisions without knowing the true situation, in order to get illegal profits or avoid losses*”. Besides some new types of manipulative behaviours were clearly provided, including disseminating false or misleading information by investment advisors, intentionally increasing or decreasing the price of a security’s price taking advantage of their office.

On the base of the former legislations and experiences in practice, the Securities Law was finally adopted at the end of 1998. Market manipulation is clearly prohibited by the law.⁴⁶⁷ And in Article 71 of the Securities Law, three types of manipulation, including manipulation by actual purchases, wash sale, and matched orders, are expressly stated. Besides a catch-all rule concerning manipulation by other measures is also provided in the same article.

Furthermore, administrative sanctions are formerly stipulated by law. Any person perpetrating manipulative behaviours should be confiscated and fined for an amount between one and five times of his illegitimate earnings. For those cases that are serious, criminal liability is available with the amendments of the Criminal Law in 1997.⁴⁶⁸ The Securities Law is a milestone for regulating the securities market, and its issue has encouraged further legislation and enforcement regarding market manipulation.

6.3.1.3 Market manipulation regulation after 2005

With the fast development of the financial market in China, legislations of financial market were outdated, so a big wave of regulatory reform was made in China around 2005. Market manipulation rules were also included, and important adjustments were made for increasing its deterrent effects and enforcement efficiency.

Firstly, mistakes or improper descriptions of market manipulation are changed to correct the mistakes or to make the identification easier and clearer. On the one hand, the subjective element that requires illegitimate interest or passes risks on others is abandoned in the 2005 Securities Law. Such subjective requirement is not only very difficult to judge in practice, but also useless, as manipulative behaviors will make damages to the securities

⁴⁶⁷ The Securities Law (1998), Article 5.

⁴⁶⁸ The Criminal Law (1997), Article 182.

market and investors no matter the manipulators get benefits or not.⁴⁶⁹ This amendment is also in accordance with changes made in the US and the EU.

On the other hand, impractical or ambiguity provisions have been revised. For example, the expression of wash sale before the amendments was “*purchase or sell securities that do not transfer ownership, considering the buyer or seller himself as the trading object*”. However, it was impossible to operate in practice, because a person is forbidden to open several accounts under his own name according to law. Therefore, in the new Securities Law, this expression has been changed into “*conducting securities transactions among the accounts actually controlled by oneself*”.

Secondly, the sanctioning regime of market manipulation has been improved. Manipulators are subject to more serious punishment than before. In the situation of market manipulation made by legal person, both the legal person and the person directly in charge of the unit as well as the other persons directly responsible are subject to punishment. In addition, the level of sanctions has been increased according to the new rules. For example, manipulators could be punished up to 10 years of imprisonment, which is five years more than before.⁴⁷⁰ Furthermore, investors who suffer lost from market manipulation are able to claim compensation from the perpetrators pursuant to the 2005 Securities Law.⁴⁷¹

And finally, some technical rules concerning the identification or punishment of market manipulation are provided. These rules are mainly included in two regulations. One is the *Indication for the Identification of Securities Market Manipulation* published by CSRC in 2007. Although this indication does not have binding effects, it provides a guideline for determining market manipulation. Eight types of manipulation are clearly interpreted,

⁴⁶⁹ Cai Yi, Cheng Hongxing, “Analysis of Important Amendments of the Law of the People's Republic of China on Securities”, Shen Zhen Stock Exchange Reach Report No. 125, 2006.

⁴⁷⁰ Criminal Law (2006), Article 182

⁴⁷¹ Although the civil liability is provided in the new Securities Law, this rule is not applicable in practice since that related judicial interpretation and implementing rules are not given. See Cheng Xiao, “Study on the Market Manipulation and its Civil Liability”, *Science of Legal*, Issue 4(2001), p.93.

three of which (successive trading, matched orders, and wash sale) are the same with those stipulated in the Securities Law, and the other five new types (scalping, fictitious orders, marking the end, trading on certain time or price, manipulation based on false or misleading information) are complements to the 2005 Securities Law, and help the supervisor with the identification of market manipulation.

The other important regulation is the *Joint Supplement Regulation of the Supreme People's Procuratorate and ministry of public security on the prosecute standard of criminal offences concerning financial affair*, which provides a detailed standard for determining “serious” that is a necessary element to apply criminal liability.

To sum up, there is not a single specific legislation for the regulation of market manipulation. The Chinese market manipulation regime is provided in related laws and administrative regulations. The main legal resources of market manipulation includes the Securities Law (Article 5, 77, and 203), the Criminal Law (Article 182), the *Interim Provisions on the Administration of the Issuing and Trading of Stocks* (Article 74), and the soft law, *Indication for the Identification of Securities Market Manipulation*. These rules constitute an imperfect market manipulation regime, and a lot of changes should be made in the further to ensure an efficient regime for combating market manipulation.

6.3.2 Determination of market manipulation in China

Since judicial precedent does not have a binding effect in China, determination of market manipulation is strictly stick to the law. Although there were regulations that tried to provide a general definition of market manipulation,⁴⁷² it is avoided by the 2005 Securities Law, which only describes some typical examples.

6.3.2.1 The subject and subjective element of market manipulation

⁴⁷² Such as *Interim Measures for the Prohibition of Securities Fraud*, Article 7; and the *Announcement on the Prohibition of Market Manipulation* published by CSRC, Article 1.

Article 77 of the 2005 Securities Law clearly provides that “*No one is allowed to manipulate the securities markets*”. Since a person who perpetrates this illegal behaviour could be nature person, legal person, or other entities that have legal personality, market manipulation prohibition, therefore, targets all the subjects that mentioned.

With regard to subjective element, the requirement that manipulation is done for getting illegitimate interest or passing risks on others, which was provided in the 1998 Securities Law has been deleted in the 2005 version. However, this does not naturally mean that intention is not a necessary element to determine market manipulation as the EU effect-based definition. In practice, intent is still a required condition according to some published judgments.⁴⁷³ As a result, further interpretation is needed to clear this confusion.

6.3.2.2 Typical types of market manipulation provided in the law

Wash Sale is one of the most commonly used means in the Chinese securities market. It is being prohibited by Article 77(3) of the 2005 Securities Law, Article 183(3) of the Criminal Law, and Article 74(4) of the *Interim Provisions on the Administration of the Issuing and Trading of Stocks*. In pursuit of related rules, wash sale is perpetrated by conducting securities transactions among the accounts actually controlled by oneself. The accounts controlled by manipulators could be the account opened in his name or other person, and they also cover accounts controlled by manipulator through investment, agreement or other means that a manipulator has the actual right to manage, use or dispose.⁴⁷⁴ In recent years, wash sale is becoming more difficult to detect, considering that, on the one side, the number of nominal accounts used by manipulator are extremely

⁴⁷³ Beijing Higher People's Court, Final Criminal Decision No.275, 2003.

⁴⁷⁴ Indication for the Identification of Securities Market Manipulation (2007), Article 28.

large,⁴⁷⁵ and on the other side, the relationship between nominal accounts and their actual controller is becoming weaker.⁴⁷⁶

Improper matched orders are another expressly provided form of market manipulation.⁴⁷⁷ It is made by “*conducting bidirectional securities transactions in collusion with another person by following previously fixed timing, price and manner, thus affecting the price or volume of securities trading*”⁴⁷⁸. Three elements are required to determine improper matched orders: 1) manipulators should be in collusion with each other; 2) carrying out bidirectional securities transactions by following previously fixed timing, price and manner; 3) affecting the price or volume of securities transition.⁴⁷⁹ However, the detection of such form of manipulation is very difficult in practice, and the most difficult part is to prove the existing of a conspiracy or a prior contract between manipulators, because trading record solo is not enough.

And the last clearly provided type of market manipulation is manipulation by actual purchases, which is stipulated in Article 77(1) of the Securities Law, Article 182(1) of the Criminal Law, and Article 74(3) of *the Interim Provisions on the Administration of the Issuing and Trading of Stocks*. It is described as manipulating the securities market by conducting allied or incessant purchasing and selling individually or in conspiracy with another person by building up an ascendancy of funds or shareholdings or taking advantage of information.

Manipulation by actual purchases has always been the most commonly used method by perpetrators in the Chinese securities market, and cases concerned usually involve a large number of fund, stocks or persons. However, the law does not provide a clear rule for its

⁴⁷⁵ Such as in the case of *Xin Yatai*, the accounts used are up to 65.

⁴⁷⁶ In the past, the nominal accounts were usually opened in the name of the actual controllers’ spouse, children and other close relatives. However, the accounts employed sometimes have no relationship with each other and are spread in a large scape.

⁴⁷⁷ Improper matched order is provided in Article 77(2) of the 2005 Securities Law, Article 182(2) of the Criminal Law and the first part of Article 74(1) of *Interim Provisions on the Administration of the Issuing and Trading of Stocks*.

⁴⁷⁸ The 2005 Securities Law, Article 72(2).

⁴⁷⁹ 2007 Indication, Article 26.

judgment. In order to determine a manipulation by actual purchases, an advantage, which could be funds, shareholding, information or a combination, should be existed. But the criterial of such advantage is not included in the legislations.

Except these three types of manipulation that are expressly described in the law, a catch-all provision is also provided by Article 77(4) of the 2005 securities law and Article 182(4) of the Criminal Law, aiming to cover manipulation by other means. According the practical experiences, the *Indication for the Identification of Securities Market Manipulation* (2007) lists five new forms of market manipulation as a supplement of the related legislation, including manipulation by disseminating false or misleading information, scalping, fictitious orders, marking the close and trading at the fixed time and price. In particular, fictitious orders took up about 37.5% of the administrative sanctions made by CSRC from 2007 to the middle 2011.⁴⁸⁰

Nevertheless, China is a country of continental law system, CSRC and the courts must strictly follow, not surpass to tamper, the law when deciding a case. Therefore, the supervisor and courts always hesitate to apply the catch-all provision, and judgment applying this provision will always raise serious arguments.

6.3.3 The sanctioning regime of market manipulation in China

Market manipulation is subject to civil, administrative and criminal liabilities in China. These three types of liabilities could be used independently or at the same time, but administrative liability is preferable by the legislators and supervisors, while civil liability is not applicable in practice.

6.3.3.1 Administrative liability of market manipulation

Administrative liability is an effective measure for the deterrence of market manipulation considering its efficiency and regulators' professional knowledge. It is absolutely the most

⁴⁸⁰ Cases of *Zhou Jianming*, *Zhang Jianxiong*, *Lu Daojun* and so on.

commonly used form of punishment for market manipulation in China. However, the rules concerned are too general and lack of operational technical details, which leads to inefficient enforcement.

In terms of the types of administrative liability of market manipulation, they only includes divesting illegally held securities, confiscating illegal gains, pecuniary fine (1-5 times of the illegal gains), addressing a warning. There are two points that are worth mentioning: one is in the situation where there are no illegal gains or the illegal gains are less than 300,000 RMB (about 40,000 Euro), it shall be fined no less than 300,000 RMB but no more than 3,000,000 RMB. In case of manipulation made by legal person, the person directly in charge of the entity and the other persons directly responsible should be punished at the same the time.⁴⁸¹

In terms of the constructive elements of administrative liability of market manipulation, there are no clear or commonly agreed rules, no matter in the aspect of legislation or theories.⁴⁸² Although three typical forms of market manipulation and a catch-all provision are provided in the securities law, the rules are just a simple description of the methods that manipulators used, lacking important details that needs to determine a manipulation. Questions, such as whether intent is a necessary element, what is the role of the change of trading price and volume, and who has the burden of proof, could not find explicit answer.⁴⁸³ These loopholes in such aspects will affect the objectivity, uniformity and authority of the sanction decisions as well as enforcement efficiency of supervisors.

⁴⁸¹ Where the manipulator is a unit, the person directly in charge of the unit and the other persons directly responsible shall be given a warning and shall, in addition, be fined not less than 100,000 yuan but not more than 600,000 yuan each. See the Securities Law, Article 203.

⁴⁸² He Jibao, Xu Hongtao, "A Comparative Study of the Constructive Elements of Administrative Liability for Market Manipulation", *Shen Zhen Stock Exchange*, available at http://www.csrc.gov.cn/pub/newsite/flb/lfzl/jnlffsyzn/yjyd/200701/t20070130_77325.html, last visit at 04 Feb 2015.

⁴⁸³ In the administrative sanction decisions published by the CSRC, no further details concerning the constructive elements of market manipulation are further explored. The Regulator, in general, describes the facts of the case and makes a copy of the provisions provided in the Securities Law, so it is quasi useless to analyse the elements from the decisions of CSRC.

Furthermore, there are not rules with regard to factors considered when imposing sanctions in the market manipulation regulation in China. So the level of sanctions imposed heavily depends on the supervisors, and this may cause diversities for similar cases, especially when sanctions for illegal behaviours are significantly influenced by the policy. For example, the sanctions imposed on manipulators will be heavier if they are made during a period that combating market manipulation is stressed by the supervisory authority

6.3.3.2 Criminal liability of market manipulation

Market manipulation was not punishable according to the 1979 Criminal Law. It was until 1997, after an amendment made to the Criminal Law, that criminal sanctions are applicable to manipulative offences in the securities market. Then in 1999, market manipulation in the future markets could be punished of criminal sanctions in the same way with those in the securities market. Further, the level of sanctions to manipulators has been increased by the sixth amendment to the Criminal Law in 2006, in order to enhance the deterrence effect of market manipulation.

Currently, criminal liability of market manipulation is mainly provided in Article 182 of the Criminal Law. The same three types of manipulation, as provided in the 2005 Securities Law, are subject to criminal punishment. Identically, a catch-all rule is also stipulated in Article 182(4) of the Criminal Law, aiming to dealing with the new coming types of manipulation employed in the practice.

For sanctioning market manipulation, certain conditions should be satisfied. Firstly, a manipulative behaviour should be perpetrated with intent, while it does not matter whether illegal profits or other interests are realised or not. Secondly, not all manipulative offences provided in the Securities Law are criminal punishable, but only cases of seriousness. And the standard to determine “serious” could refer to Article 39 of the *Notice of the Supreme People's Procuratorate and the Ministry of Public Security on Issuing the Supplementary*

*Provisions to the Provisions (II) of the Supreme People's Procuratorate and the Ministry of Public Security on the Standards for Filing Criminal Cases under the Jurisdiction of the Public Security Organs for Investigation and Prosecution (hereinafter the Notice)*⁴⁸⁴.

In the case of wash sale or improper matched orders, the accumulated trading volume of the speculated securities or futures in successive 20 trading days should not be less than 20% the total trading volume; in case of manipulation by actual purchases, the manipulator should be in possession of or control at least 30% of the tradable securities which are subject to speculation, and the trading volume of manipulated subject in 20 successive trading days should not be less than 30% of the total trading volume; and manipulation perpetrated by directors, supervisors, managers, or controlling shareholders of the listed companies, securities companies, securities investment advisors, professional intermediary institutions and their employees should be considered as serious.⁴⁸⁵

In addition, both nature person and legal person are punishable for the commitment of market manipulation. When the perpetrator is a nature person, he could be sentenced to a fixed-term imprisonment of not more than five years or criminal detention and shall, in addition, or shall only, be fined; and if the circumstances are especially serious, he shall be sentenced to a fixed-term imprisonment of not less than five years but not more than ten years and shall, in addition, be fined. When the perpetrator is a legal person, not only the legal person *per se* shall be fined, but also the person directly in charge or the other persons directly responsible shall be punished according to the rules for nature person.

Nevertheless, similar issues exist in the criminal sanctioning regime for market manipulation with that in the administrative sanctioning regime. One is concerning the application of the catch-all provision. This rule aims to avoid the situation where new forms of market manipulation are not covered by the law. However, its uses sometimes cause arguments relating to the principle of “*conviction and penalty according to law*”,

⁴⁸⁴ No. 47 [2011] of the Ministry of Public Security

⁴⁸⁵ Article 39 of the Notice

and judges, therefore, are unwilling to apply it in practice.⁴⁸⁶ The other one is with regard to factors considered when making a criminal decision. Since the Criminal Law does not provide the factors which influence the type or level of the criminal sanctions, judges enjoy more discretion over sanctions for market manipulation, and this may lead to unequal judgments for similar cases.⁴⁸⁷

6.3.3.3 Civil liability of market manipulation

The initial provision concerning civil liability of market manipulation is stipulated in Article 77 of the *Interim Provisions on the Administration of the Issuing and Trading of Stocks*, which provides that “Any person, who breaches the rules in this regulation and causes damages to other person, should be liable for the compensation liability.” However, as no implementing rules were accompanied, the civil liability regime is just hollow words. Then during the draft of 1998 Securities Law, although civil compensation was proposed by some experts to ensure the rights of investors in the securities market except from administrative and criminal liabilities, it was still not approved in the final version.

Investors who suffer from market manipulation are finally allowed to request civil compensation according to the 2005 Securities Law, while this rule is still literal in China taking into account the lack of rules with regard to constructive elements, the scope of subject, the identification of damages, the amount and scope of the compensation. For example, in the first case of reparation for damages of market manipulation, two defendants (Cheng Wenshui and Liu Yanze) were judged to manipulate the securities market by CSRC in April 2009. After the publication of administrative decision, 18 retail investors seek to ask compensation for damages suffered from their manipulative behaviours in July 2009. Unfortunately, both the intermediate court and the Higher

⁴⁸⁶ Wang Chongqing, “Analysis of criminal nature of “scalping”: from the market manipulation case of Wang Jianzhong”, *Politics and Law*, Issue 1 (2011), pp.44-50.

⁴⁸⁷ Li Yang, “On Determination for Crime of Rigging Securities Exchange: Focusing on Wang Jian Zhong Case”, *Law Science Magazine*, Issue 4 (2012), pp. 168-173.

Peoples' Court in Beijing denied the application of investors in 2011 on the basis that there were no clear and definite legal provisions or judicial interpretations for this case and the causation between the losses of investors and manipulative behaviours could not be determined.⁴⁸⁸ Similar situation happened to the case of Wang Jianzhong.⁴⁸⁹

Despite legislations and judicial practices concerning civil liability are not ideal, most of the scholars are making efforts to improve this regime in China. It is commonly agreed by experts that granting investors the right to bring the case before the court for seeking compensation caused by market manipulation is an efficient way to prevent market manipulation, to increase enforcement efficiency, and to ensure the smooth functioning of securities market.⁴⁹⁰

Although the provisions in the Securities Law are not applicable, experts conclude the constructive elements of civil liability for market manipulation according to the civil law theory, which include: a) manipulators should be responsible for the compensation; b) an intention to acquire illegal profits or to pass risks to other investors is required; c) there should be an causation between the manipulative behaviours and the damages suffered; d) losses of investors should exist and the scope of the losses only cover the actual losses, not include anticipated profits.⁴⁹¹

⁴⁸⁸ Wen Yu, "Drama of the First Reparation for Damages Suffered in Market Manipulation Case", *Securities Times*, 25 Feb 2012, A4; And Wen Yu, "Deny of the First Reparation for Damages Suffered in Market Manipulation Case in the Second Hearing", *Securities Times*, 12 May 2012, A4.

⁴⁸⁹ Li Lin, "Crime and Punishment of Black Mouth in the Securities Market: examination of the market manipulation case of Zhong Hengxin", *Company Law Comment*, Issue 2012, pp. 347-348.

⁴⁹⁰ Cheng Xiao, "Study on the Market Manipulation and its Civil Liability", *Science of Legal*, Issue 4(2001), p.91; Jing Changyu, "Research on the Regulation of Securities Market Manipulation", *doctor thesis*, Ji Lin University, 2012, Ji Lin, China; Wang Hongguang, "Research on the Constructive Elements of Civil Liability for Market Manipulation", *Judicial Research Forum*, Issue 15 (2009), pp. 84-87; Song Yixin, "Legal Issues of Civil Compensation Caused by Market Manipulation through Insider Trading in Securities Market", *Legal Application*, Issue 4 (2006), pp. 65-69.

⁴⁹¹ Jia Wei, "The Identification of Market Manipulation and Civil Liability", *People's Judicaure (Application)*, Issue 17 (2007), pp. 12-16; and Wang Hongguang, "The Constructive Elements of Civil Liability of Market Manipulation", *People's Judicaure (Application)*, Issue 15 (2009), pp. 84-87.

6.3.4 Issues of Chinese characters concerning market manipulation regulation

The current Chinese market manipulation regulation is far from efficiency according to previous analysis. And this could partially explained by some reasons of Chinese character.

Firstly, false ideas are hold by the legislators and supervisors. The Chinese legislators always try to make a law, which could cover all the possible problems in the securities market. However, this is quasi an impossible aim to realize. Therefore, as a replacement, catch-all provisions are commonly seen in the law. While China is a country of continental law system, judges and supervisors are required to make decisions strictly in pursuit to the legislation. As a result, the catch-all provisions, which are general descriptions without further implementing details, are rarely applied in practice in order to avoid arguments concerning their decisions. And because of such fears, legislative or supervisory gaps still exists when dealing with new coming cases.

Secondly, current market manipulation rules are short of operational details. The provisions in the Securities Law does not provide clear answers to the constructive elements of market manipulation, such as, whether subjective element manipulator is required or not, or whether a result of changes of the trading price or volume of a security is needed. Consequently, supervisors do not have a clear legal basis to reply on during their work, which significantly affects the enforcement of market manipulation regulation.

Thirdly, the double role of CSRC becomes an obstacle for combating market manipulation in China. CSRC is the supervisor of securities market, while she is also responsible for the development of the market. Such double identities lead to a situation where CSRC, in particular its regional inspections, is reluctant to investigate manipulators, who have large influence on the securities market, because, the breaking down of these manipulators (usually important enterprises), may destroy some of the achievements made in the securities market.

And lastly, administrative intervene and other powers from the authority threatens the enforcement of market manipulation regulation. According to practical experiences, manipulation cases investigated by the CSRC are usually of great influence, and manipulators also contribute to regional economy or even national economy. Therefore, local governments sometimes are unwilling to cooperate with the supervisors or to provide helps with market manipulation investigation, considering that the result might lead to a fall back of local economy at least in a short term. This is also a quite specific reason of China for the inefficient enforcement.⁴⁹²

6.5 Improving the market manipulation regime in China: drawing on EU's experiences

Although there are some differences with regard to market manipulation in the financial markets between EU and China, most of the key issues are commonly shared, such as the definition and determination of market manipulation, sanctions, and preventive measures. The EU market manipulation regulation provides a good mechanism concerning the prevention and detection of cross-border market manipulation, which is of extremely importance for the Chinese market manipulation regime, considering the close relationship between the Chinese mainland securities markets and Hong Kong securities but different regulatory and supervisory systems. Therefore, it will contribute to the improvement of Chinese market manipulation regime by studying EU experiences.

6.5.1 Creating multiple level of legal resources for market manipulation regulation

The legal resources of market manipulation regulation in China are too simple, which are only composed of two articles of the securities law, one article of the criminal law and three articles of an administrative regulation. Further, the contents of these articles are quite similar with each other. It is undebatable that such few articles could not constitute

⁴⁹² He Jibao, Xu Hongtao, "A Comparative Study of the Constructive Elements of Administrative Liability for Market Manipulation", *Shen Zhen Stock Exchange*, available at http://www.csrc.gov.cn/pub/newsite/flb/lfzl/jnlfssyzn/yjyd/200701/t20070130_77325.html, last visit at 04 Feb 2015.

an effective regime for regulating the complex situation of manipulation in the securities market, not mentioning the new coming types of manipulation with the development of financial products and new technologies. Besides, China is not a case law system, so the judgments of the courts concerning market manipulation cannot be used to complete the loopholes of laws concerning market manipulation. As a result, many issues concerning the regulation of market manipulation are still blank, which need further legislation.

Comparatively, the legal resources of EU market manipulation regulation are more sophisticated. They could be divided into several levels: The principle framework is provided in the regulation and directive, technical standards are stipulated in the Commission implementing directives or regulations, and further details of some specific rules are explained in the soft law published by ESMA to ensure a uniform enforcement. Such structure of legal resources could on the one hand avoiding unclear provisions which might lead to hesitation during enforcement, and decreasing the possibility that the regulation of new coming issues are lack of legal basis, on the other hand.

Consequently, it would be better to create multilevel legal resources for market manipulation regulation for ensuring efficient enforcement. To be specific, on the basis of Article 77 of the Securities Law, the State Council should issue an administrative regulation, providing further details concerning the determination and sanctions of market manipulation. In addition, CSRC could publish some soft law, through which making explanation of arguable rules in the legislation to ensure the clarity and operationalism. Furthermore, it would greatly increase the enforcement of market manipulation regulation and supervision if related judgments have binding effects.⁴⁹³

⁴⁹³ He Jibao, Xu Hongtao, “A Comparative Study of the Constructive Elements of Administrative Liability for Market Manipulation”, Shen Zhen Stock Exchange, available at http://www.csrc.gov.cn/pub/newsite/flb/lfzl/jnlffssyzn/yjyd/200701/t20070130_77325.html, last visit at 04 Feb 2015.

6.5.2 Providing a clear definition of market manipulation

As a matter of course, a clear definition of market manipulation would highly benefit its regulation and supervision. The definition also has a special meaning for the Chinese securities market, as it could help market participants to have a better understanding of the illegitimate nature and damages of market manipulation, as well as legal liabilities, and then to reduce this common seen wrong-doing.

Although the *Interim Provision of the Prohibition of Securities Frauds of the State Council* (1993) and the *Announcement on the Prohibition of Market Manipulation* (1996) published by CSRC had tried to define market manipulation, these two definitions did not successfully pointed out the nature of market manipulation, and narrowed the scope of market manipulation only to the behaviours taking advantages of capital or information. However, the definition issue is avoided by the Securities Law, which only describes three typical forms of market manipulation, and the key elements of are also not well provided. For example, there are no clear rule concerning the subjective elements of manipulator and the objective elements are lack of operative details.

The EU Market Abuse Directive is recognized as the first legislation that defining market manipulation formally. In particular after the reform, the definition of market manipulation provided not only provides a general description of the characters of market manipulation, but also stipulates several typical forms and detailed indications, which ensures, to the highest degree, clarity and generality of the definition. This kind of method to define market manipulation is highly recommended in China. On the one hand, a general definition will avoid regulatory gaps when new forms of market manipulation comes out; on the other hand, sub-definitions of typical manipulation and indications will reduce the discretion and hesitation in the judicial practices.⁴⁹⁴

⁴⁹⁴ Li Mingliang, Li Hong, “Comments on the Proposed Market Abuse Regulation in the EU: concurrently on the objectivity and socialization of the determination of financial crime”, *Securities Market Report*, November 2012, pp. 10-14.

Therefore, in the future legislation concerning the definition of market manipulation, not only a general definition should be provided, but also should pay attention to the typical forms. In terms of typical forms of market manipulation, the number listed in the law is too limited, so more types should be added, in particular the information based manipulation and cross-markets manipulation.

6.5.3 Adding derogations to market manipulation

Considering the complexity of market manipulation and the blur borderline of legal trading and manipulative transitions, it is a common rule to provide derogations to the market manipulation in many important countries and districts. Buy-back programmes and stabilization are two derogations to market manipulation provided in the EU market manipulation regulation. However, the Securities Law in China does not expressly provide this regime.

In terms of buy-back programmes, it is allowed in the securities market according to Article 142 of the Companies Law of the People's Republic of China (2014), restrict to the four specific aims,⁴⁹⁵ and these shares bought by the company should be transferred within designated dates, so it is almost impossible to perpetrate manipulative behaviours during the buy-back program. For example, as treasury stock regime does not exist in China, the shares bought by the company will be either transferred to the staff or employee, or being cancelled within certain times, and this greatly reduce the space for market manipulation. However, buy-back programme is not mentioned in the securities law as safe harbour to market manipulation. For the clarity, it is better to provide that buy-back programme is an express derogation to market manipulation.

In terms of stabilization, it is prohibited in the Chinese securities market according to the related legislation. For a long time, the new issued stocks are always short of supply, so

⁴⁹⁵ These four aims include reducing registered capital, merging with another company that holds its shares, rewarding the staff and workers of the company with its shares, or requesting the company to purchase his shares because he holds objections to the resolution on the merger or division of the company adopted by the shareholders general assembly.

there is no worry of the failure to issuing stocks. However, with the reform of issuing regime and usage of inquiry system, the price of stock issued sometimes is lower than issuing price, which may result in failure of issue. Therefore, the stabilization regime, aiming to ensure the success of issuing, will be necessary for the Chinese securities market in the future.

Further, if derogations are provided in the future securities, they should follow the example of EU market manipulation regime, which provides technical standard rules concerning conditions, limitations and procedure with regard to the application of buy-back programmes and stabilization.

6.5.4 Emphasizing preventive measures of market manipulation

Preventing is better than curing. One of the most important changes made in the EU market manipulation regulation reform, is encouraging suspicious transition reports. It is proved in practice that whistle-blowing regime is an efficient and economic measure for the detection of market manipulation, particularly in complex cases. Nevertheless, the important preventive measure does not raise enough attention in China, and there is no law concerning it.

In practice, a person could report the transitions that are suspicious of involving market manipulation to the CSRC, either through letters or telephone. Despite these reports contribute to about 25% of the detection of market manipulation cases, many issues have also been exposed: firstly, the reporters usually are outsiders, and information provided does not include higher percent of useful information; secondly, the procedure of dealing with reports is not transparent, and reporters could not know the result of his report; and thirdly, there are no clear protection for the identity or other private information of the reporter, even though the report could be made anonymously.

As a result, there should be adequate protections for the whistle-blowers in order to encourage the application of this preventive regime. The protective measures should at

least conclude that identities of reporters and other private information should be kept confident by the law, and monetary awards could be used to encourage more people to provide useful information. Meanwhile, certain conditions and punishments, as stipulated in the EU rules, should also be provided in order to avoid report with bad intention.

6.5.5 Refining the liability regime of market manipulation

Although administrative, criminal and civil liabilities for market manipulation are all provided in the related legislation, enforcement of market manipulation regulation is not efficient, and there are many issues relating to these three sanctioning regimes in China.

Firstly, the regulators in China heavily relies administrative sanctions to punish manipulators, criminal sanctions are used less, and civil compensation is still not applicable in practice. However, the related legislations do not provide a mature sanctioning regime of market manipulation, the constructive elements of which are still not clear, no matter in legislation or in theory. In order to increase enforcement efficiency, market manipulation regulation should provide a clear answer to questions whether the result of changes of stock price is needed or not, whether intention is a necessary element or not and so on.

Secondly, increasing the types of sanctions for market manipulation is another important way to refine the liability regime. In the EU market manipulation regulation, pecuniary sanction and non-pecuniary sanctions are equally important. Non-pecuniary sanctions, such as warning, temporary or permanent prohibition to provide service, judicial supervision, play an important role in preventing repeated offences. None the less, the types of sanctions for market manipulation are quite limited in China, which could not ensure the efficiency of enforcement. The administrative sanctions only include confiscating illegal profits, fine and addressing a warning. So providing multiple types of sanctions as provided in the EU regulation could ensure proper punishment is imposed on different cases.

6.5.6 Enhancing supervisory cooperation

With the globalization of international financial markets, the number of cross-markets and cross-broader manipulation are increasing. Manipulators could get giant illegal profits while escape from punishment because of poor supervisory cooperation among various supervisors. So in the EU market manipulation reform, strengthening the cooperation system of supervisors in Member States and third countries is one of the key areas that amendments made.

This gives a warning to China. On the one hand, the influence between the securities market and the futures market, as well as commodities market are getting closer, as the creation of multi-level capital markets in China,. And manipulation case cross securities market and future markets has come into sight in China. On the other side, cross-border securities transitions become more and more frequent in China in the wake of globalization of financial markets. In particular, the interaction between securities markets in the mainland of China and Hong Kong is quite significant. For instance, many Chinese companies choose to list on the stock exchange in Hong Kong, and investors make transitions on both sides of the markets. However, the regulatory and supervisory systems are very different, which provides opportunities for manipulators to take advantage of such differences.

Therefore, the problem concerning regulatory arbitrage in the EU is also a concern for the Chinese securities market, and improvement should be made to ensure effective prevention of cross-border manipulation. According to the EU experiences, the Chinese market manipulation regime should also establish an efficient cooperation system between CSRC and supervisors in other sections and in other countries, especially in respect of information exchange and investigation cooperation.

Conclusion of Chapter 6

The Chinese securities market develops quite late while with a high developing speed. Since the very beginning of its establishment, market manipulation has been one major issue of the securities market in China. It is no exaggeration to state that the Chinese securities market is a giant casino for investors.

The reason why market manipulation has become such a serious problem for the smooth functioning of securities market and protection of investors in China could be explain from two aspects. One is special reasons concerning Chinese characters, including the wrong ideas of legislators and supervisors concerning catch-all provisions and their application; double role of supervisors; and non-cooperation of local government or authorities because of specific interests. The other reason is with regard to failure of market manipulation regime, which could benefit from studying EU experiences relating to market manipulation regulation.

With 20 years' effort, the Chinese market manipulation regime has been established, which, however, is far from mature. Therefore, studying from the success example, the EU market manipulation regime, will help to refine the regime in China. In terms of legislative structure, multi-level legal resources of market manipulation regulation should be created, in order to uniformity and flexibility of the regime. In terms of the prohibition and identification of market manipulation, a clear definition and supporting administrative rules concerning indications, signals and typical examples should be provided to enhance market understanding of relate activities. Besides, in conformity with international regulation, derogations, like buy-back programmes and stabilization, are supposed to be added into the Chinese market manipulation regime, avoiding that legitimate behaviours are caught by wide scope of prohibitions.

Further, reform should also be made to enhance supervision and enforcement. Preventive measures, particularly whistle-blowing regime, will be effective measures that help

regulators to detect and investigate suspicious manipulation. And another emergent regime that needs to refine is the sanctioning regime, the constructive elements of which should be clearly provided, so as to achieve the objective of efficient enforcement. Finally, in response to an increasing number of cross-border and cross-markets cases of market manipulation, it will be necessary for CSRC to establish effective supervisory cooperation system with regulators in other districts (notably Hong Kong) and countries.

Conclusion

Market manipulation is an illegal practice that enables a person to profit from practices that artificially raise or lower the prices of an instrument in the financial markets. It makes damages to the smooth functioning of financial market by distorting its price formation mechanism, and also destroys investors' confidence. Therefore, market manipulation is commonly banned in the main countries, basing on the rationales of supporting market efficiency, lowering the cost of capital and protecting morality.

The prohibition of market manipulation typically addresses the dissemination of false or misleading information, behaviors that distort the trading price or trading volume of a security, and misuse of material information (supplement to rules of insider dealing).⁴⁹⁶ However, there are difficulties to efficiently tackle market manipulation taking into account its complexity. Manipulative activities can be perpetrated not only by fraudulent misrepresentations that are relatively straightforward, but also by highly complex and difficult-to-detect trading practices. Further, market manipulation is continually evolves with the development of new financial products and high technologies.⁴⁹⁷

The EU market manipulation regime is established by the 2003 Market Abuse Directive, which was the first FSAP measure to adopt under the then novel Lamfalussy process.⁴⁹⁸ And this regime is supported by four Commission administrative rules and three sets of CESR guidance. Despite weakness in implementation and supervisory consistency emerged from the very beginning, the market manipulation regime under Market Abuse Directive was broadly considered as a big success, which has achieved the main objectives of enhancing financial market integrity and public confidence in the EU financial markets.

⁴⁹⁶ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, p. 703.

⁴⁹⁷ *Ibid.*

⁴⁹⁸ *Ibid.*, p. 709.

The market manipulation regime under Market Abuse Directive provides a clear definition of market manipulation, supplementing by possible signals and typical examples. Since the effect-based approach is adopted, the prohibition covers a broad scope of activities, so two safe harbours, buy-back programmes and stabilisation and AMPs are stipulated to avoid overly prohibition. For better supervision and enforcement, competent authorities are conferred with a minimum list powers that Member States should ensure. In terms of administrative liability of market manipulation, constituent elements are also elaborated. Furthermore, a couple of preventive measures in the market manipulation regime, especially suspicious transaction reports, contribute to the deterrence of illegal behaviours in the financial market.

Review of the current market manipulation regime is made benefiting from post-FSAP commitment to Better Regulation, and this review soon became incorporated within the wider EU crisis-era reform programme.⁴⁹⁹ A number of weaknesses have been identified on the basis of contributions collected from public consultations and expert reports, which include regulatory gaps in the terms of trading venues and of financial instruments, notably market manipulation in commodity derivatives and related spot markets; legal uncertainty caused by AMPs; inefficient enforcement linked to limited national competent authority powers and cooperation system among EU securities regulators; and regulatory arbitrage as a result of sanctioning divergences.⁵⁰⁰

Therefore, a new regulatory package of market manipulation has been adopted to refine the current market manipulation regime. Market Abuse Regulation and Directive on criminal sanctions for market abuse will repeal Market Abuse Directive as well as its related supporting administrative rules, and a deeper harmonisation at EU level is made. On the one hand, a structure reform is taken with regulation replacing directive to be the cornerstone of market manipulation regulation, which will ensure a higher definite and

⁴⁹⁹ Niamh Moloney, *EU Securities and Financial Markets Regulation*, p. 710.

⁵⁰⁰ *Ibid.*

directly binding legislative system, and significantly reduce divergences during enforcement of Member States.

On the other hand, substantial reform is at the centre place of the reform, aiming to efficiently prevent market manipulation in the EU financial markets, in particular cross-border and cross-markets cases. The new market manipulation regime will expand beyond an original prohibition on a range of manipulative behaviours, extending the regime to include manipulation relate to commodity derivatives, HFT, emission allowance, and benchmarks. And a better definition of market manipulation will be provided by that Market Abuse Regulation bring indicators, signals and typical examples of market manipulation, which are currently provide in supporting administrative rules of Market Abuse Directive, into the Regulation and its Annex.

Meanwhile, attempted market manipulation is added as a new prohibition, in order to catch behaviours that do not successfully realize the result of speculating the price, the supply or demand of an instrument. Further, the AMP regime will be further harmonised with greater scrutiny of ESMA to reduce divergences among Member States.

Market Abuse Regulation also tries to enhance its efficiency of supervision and enforcement. A broader minimum list of powers that should be conferred on national regulators is provided to add or strengthen powers of competent authorities, in order to support effective intra-Member State and cross-border supervision. And the supervisory cooperation has been extended by covering a wider scope of information and subjects. More significantly, ESMA is not limited to the role of mediator, but also could impose directly binding decisions on national competent authorities, or even market participants, when settling disagreements between national regulators.

Further, preventive measures of market manipulation, particularly whistle-blowing, have been refined, reflecting international trends as well as similar measures in other crisis-era

securities and markets measures.⁵⁰¹ Protections of blowers and procedure for receipt of reports and follow-up are specified in the new regime. Financial incentives may be also granted, which depends on the choice of national law.

And finally, more changes are made to ensure efficient enforcement. Administrative sanctions has been specified through providing a minimum list of the types and levels of measure and sanction available, publishing sanctioning decisions, and imposing reporting obligations on national competent authorities and ESMA to enhance monitoring and support convergences.⁵⁰² And criminal sanctions regime is introduced into the new market manipulation regulation. Directive on criminal sanctions for market abuse has made a minimum harmonisation to criminal sanctions of market manipulation, and Member States could choose retain or impose stricter rules.

In general, the new EU market manipulation regime will not only significantly enhance the efficiency of supervision and enforcement, but also will reduce divergences in Member States, contributing to the establishment of a uniform market abuse regime at the EU level. However, some issues, such as, interpretation of “reasonable suspicion”, the criteria to decide “seriousness”, need to be further interpreted to achieve this objective.

In addition, fundamental rights should be respected in the implementation of regulations of market manipulation. And an assessment relating to balancing the prohibition of market manipulation and protection of fundamental rights should be made in practice. Three types of fundamental rights are of particular relevance to the market manipulation prohibition, including freedom of expression; the right to private and family and the right to protect personal data; and the fundamental rights concerning justice. The new EU market manipulation regime has set out conditions to avoid abusive powers of competent authorities and measures to ensure procedure rights of suspected persons who commit

⁵⁰¹ Niamh Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, pp. 761.

⁵⁰² *Ibid*, pp. 764-765.

manipulative offences. However, the success will highly depend on Member States, who are obliged to ensure proper measures are provided in the national law.

At last, the EU market manipulation regime could be of significant reference to China. Market manipulation has been a serious problem for the smooth functioning of securities market and protection of investors since the very beginning. And the current Chinese market manipulation regime is far from mature. A number of measures that could study from the EU market manipulation regime to refine the Chinese one, which include creating multi-level legal resources of market manipulation regulation to guarantee uniformity and flexibility of the regime, providing clear definition and supporting administrative rules concerning indications, signals and typical examples to enhance market understanding of relate activities, establishing safe harbours (buy-back programmes and stabilization) to avoid that legitimate behaviours are caught by wide scope of prohibitions, strengthening whistle-blowing regime, enhancing cross-border supervisory cooperation and providing clear constructive elements of sanctions to market manipulation to guarantee efficient enforcement.

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