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Broker Scandals in 2015 in Hungary¹

“It is not enough that the (foreign) ministry keeps citizen’s money in high risk junk bonds, it also makes decisions based on insider information, and more quickly saves its “own” money than that of depositors.”²

Tens of thousands of Hungarian depositors and investors have been affected by the loss of hundreds of millions of EUR worth of assets. Local governments and various non-profits have lost hundreds of millions. Brokers have been arrested. At least one professional football club stands on the brink of bankruptcy. It turns out the Foreign Ministry kept billions of taxpayer money in high risk junk bonds. All of this has happened since police raided the Budapest headquarters of the Buda-Cash Broker House the night of February 23rd 2015.³

Hungary’s government denied insider trading after opposition members questioned a foreign ministry decision to withdraw state funds from a brokerage that filed for bankruptcy a few days later. The National Bank of Hungary suspended the licence of brokerage Quaestor on March 10, saying it may have sold more bonds than permitted under its issuance programme. The Hungarian opposition parties urged the foreign ministry to clarify whether it had any insider information about Quaestor’s finances. “The foreign ministry and its institutions had no unlawful information whatsoever,” it said on the government’s website. Quaestor was the third Hungarian brokerage to run into financial trouble within weeks in 2015.⁴

¹ This paper was supported by the János Bolyai Research Scholarship of the Hungarian Academy of Sciences.

² <http://budapestbeacon.com/public-policy/brokerage-scandal-engulphs-hungary/21158> (30. 08. 2016.)

³ <http://budapestbeacon.com/public-policy/brokerage-scandal-engulphs-hungary/21158> (30. 08. 2016.)

⁴ <http://www.euronews.com/2015/03/27/hungary-orbans-government-denies-insider-trading> (30. 08. 2016.)

Before we analyse the criminal law aspects of the Hungarian broker scandals in 2015, we have to summarise the Hungarian criminal law regulations regarding this topic, especially the Hungarian concept of the insider trading in the Criminal Code and in other legal regulations outside of the criminal law as well.

In a traditional market the customers bear all the relevant information, which is needed before making the decision of the actual purchase. They can analyze the product or even compare it to an other merchant's offer. The stock exchange, as one of the means of the modern wholesale trade, shows similarities but even more dissimilarities with the regular market. As we know, it has two basic types: one of them is the stock exchange (or market), where securities, especially shares and bonds are traded, and the other is the commodity exchange, where usually raw materials (wheat, corn, coffee, rock oil, etc.) as well as eventually foreign currency are merchandised. The very first stock exchange of the world was founded in Amsterdam during the turn of the 16th and 17th centuries, but nowadays the word 'stock exchange' does not necessarily mean an actual physical location, it is rather considered as a certain gathering of the actors of the market, who are connected to each other by formal trading rules and communication networks. These performers appearing in the stock market make investment decisions. A contrary to the regular market, where the customer decides on the ground of costs collated to the expected profits, during concluding a decision of investment the investor concentrates on two matters: the anticipated future yield and the risk. In order to conclude a proper decision they need the most information available. These investors expect that all the relevant information is true, holistic and available for everybody in the same time and same amount and all of these are guaranteed by strict rules. The ideal goal would be to provide the same amount of information for everybody in every moment. Because of these the undertakings of the stock exchange have to publicize certain datas by time to time and it is also declared everywhere among the principles, that insider trading and market influencing is forbidden. The perpetrator of insider trading basically harms other performers of the market by his/her act. If he sells securities wherewith he holds unflattering information, then the customer comes off badly, but if he is expecting the rise of the rates, he pulls out the money of the pocket of those, who would have kept their position. Insider trading can also cause harms on a macro level, because it can result the pullout of foreign investors and capital from the market.

Hungary joined the European Union on 1 May 2004 and became its member with full rights. In addition to the starred blue flag, we adopted the complete legal material, European law, as well, which poses serious challenges to the actors of jurisdiction, and has an effect on economic criminal law. This effect, however, for the time being may only be indirect, as the bodies of the European Union at present cannot yet create criminal law norms that could be directly applicable in the member states. Even earlier, we were watching with interest and sympathy the endeavours aimed at the creation of a unified code targeting the protection of the financial interests of the Community, and we think this work – in which we would also like to take part now – is to be continued.

The main European background norm on insider trading is the new 2003/6/EC, which replaced the former 1989/592/EEC directive, but the 2003/124/EC and the 2003/125/EC directives also contain rules related to the topic. The new directives significantly widened the sphere of insider information compared to former directives. The insider information is not interpreted only in connection with securities anymore,

but this definition also includes information related to financial means and derivative securities, which leads directly to a wider range of impeachment because of insider trading.

The current Hungarian regulation on insider trading can be found in the paragraph 410 of the new Hungarian Criminal Code (the Act 100 of the year 2012.)

410. § (1) Someone who

a) transacts operation referring to a financial mean by using insider information

b) regarding to the insider information in his/her possession assigns an other to transact operation referring to a financial mean,

c) due to benefit snatching gives insider information away to an unauthorised person

commits a crime, and can be punished by maximum 3 years of imprisonment.

In Hungary this crime was unknown before 1990, but we are not at all late. In the United States there has been legal regulation related to insider trading since 1934, and since 1981 in the United Kingdom. In Germany (where the stock market bears old traditions) the regulation came into force only in 1994. The European Union declared its principles forbidding insider trading in 1989.⁵

The statement of facts of insider trading got its current form in 2005. It became shorter than the former ones (for example the 'forbidden security-trading' and the 'insider security-trading'), but it also widened the range of objects on which this crime can be committed (not only on securities but also on 'other financial means'), and at last it does not contain the definition of insider information anymore, since that is included in one of the background norms.

The Act on Capital Market of 2001 (Tpt.) stands in the background of this crime. This statute provides a vigorous competence for the State Supervision of Financial Organisations, where today a separated department deals with the problems of insider trading (Market Controlling Department). The National Bank of Hungary is authorised to charge the perpetrator of insider trading and market influencing with a penalty, if he/she violates, eludes, omits or performs late one of the provisions written in the Tpt. or in other law derived from it, or one of the National Bank of Hungary's orders or its own by-law.⁶

The penalty in the case of insider trading or market influencing can be between 100.000 and 100.000.000 Forints (400 and 400.000 Euros) or maximum the 400% of the traceable financial benefit. This could have a strong dissuasive force in several cases. The announcement making obligation is also a new element in the regulation in the case of suspicion of insider trading (and this must be fulfilled by the investment service providers), but there is no criminal sanction attached to the omission of this obligation, so it is not a crime, but it also can result a penalty. The service providers are obliged to name an assigned person, just like in the case of money-laundering, but here the announcement has to be sent to the National Bank of Hungary. The National

⁵ István Vajda: Insider Trading (Economical Journal, 50. year, 2003, p. 235-253.)

⁶ Organisations dealing with investment service providing must conclude a separate by-law on the questions related to insider trading, similarly to money-launder prevention by-laws.

Bank of Hungary decides whether it submits an accusation to the police or settles for a penalty in its own competence.

The object of the crime is the equality of chances, which is essential for stock market transactions and indirectly to fair market attitude.

The offender's behaviour is the sealing of a transaction, the crime can be committed outside the stock market. The phrase "sealing a transaction" does not mean that only the perpetrator himself must seal the transaction, in fact it is not the typical case; usually they use the assistance of some kind of a broker or commission merchant. The investment service provider – if he is unaware of the insider character of the transaction – is exempted from criminal liability on behalf of his mistake. (If only under ordinary care he should have recognised the insider transaction, the State Supervision of Financial Organs may fine him.) In the first two phrases neither the result (gaining benefit), nor the aim of gaining benefit are elements of the statement of facts, so the crime is carried out even if the perpetrator suffers losses from the transaction. The handing over of insider information to gain benefit practically means the selling of such information.

(There are disputes in the scientific literature, whether the benefit can only be a financial type or for example a moral acknowledgment (e.g. promotion) or the possibility of a sexual relationship. We are willing to accept this concept, but adding, that in practice it is not the usual perpetrational behaviour.)

The method of perpetration in the first phrase is "with the use of insider information", in the second is "according to the insider information in his possession". To interpret this, we need to specify the definition of insider information, which we can find in the Act on Capital Market.

Insider information:

1. such important information⁷ concerning a financial instrument (not including the goods-based derived transaction)
 - that is not yet publicised
 - that is directly or indirectly connected to the financial instrument or to the issuer of the financial instrument
 - that in the case of publication would be capable of significantly influence the price of the financial instrument⁸
2. such important information in the case of persons, who are assigned to execute any assignment concerning the financial instrument -excluding the ones listed in a. - that is connected to the current assignment given by the client-
3. such an important information concerning a goods-based derived transaction, which
 - was not yet publicised
 - is directly or indirectly connected to a goods-based derived transaction
 - according to the accepted market practice should be shared with the market actors
 - information is regularly shared with the market actors

⁷ important information: all information concerning an event or circumstance, that has already occurred or its occurrence is reasonably expectable, and specific enough, to enable to draw a conclusion on the possible influence of an event or circumstance on a given financial instrument's price

⁸ information capable of influencing the rate: all information that would likely be used by an investor at time of making an investment decision

The perpetrator can be anyone, so anyone can commit insider trade, who possesses insider information. The circle of so-called insider persons, who possess insider information, can be found in the background norm.

Insider person:

1. leading official and member of the supervising committee of the issuer
2. manager, leading official and member of the supervising committee of the legal person or economical partnership without a legal personality in that the issuer owns directly or indirectly twenty-five or more percent of the shares, or has a right to vote
3. leading official, member of the supervising committee and manager of a legal person or economic partnership without legal personality that directly or indirectly owns ten or more percent in the issuer or has a right to vote
4. manager, leading official and member of the supervising committee of any organisation participating in the distribution or in organising the public buying offer according to the VII. Article; furthermore any employee of these organs or the issuer, who participated in the distribution or in the issue, who got insider information during his work within a year from the distribution
5. a natural person who directly or indirectly owns ten or more percent of the issuer's capital
6. manager, leading official and member of the supervising committee of the issuer's accounting credit institute
7. who received insider information because of his work or duties, during his work or exercising his regular assignments, or in any other way
8. who received insider information through crime
9. a person living in a common household or closely related to a person listed in points a.-h.
10. a person acting on behalf of such a company, where a an insider person listed in points a.-i. owns a significant share

The crime can only be committed intentionally, in the first two phrase with *dolus eventualis*, in the third – according to the aim- only with *dolus directus*.

It makes more difficult the judicature, when some important theoretical question, which are important in the practice aren't specified perfect. Because of this that for example there are just few criminalprocess in insider transaction.

The first question is the definition of the benefit. There are two absolutely opposite opinions in the definition of benefit. One of the opinions says that the desired benefits can be a service like sexual contact, moreover a moral admission, like an improvment, not just a pecuniary thing.⁹

The justificaition of the minister proves this opinion. The justification says, that it is not important, that the transmitter or the beneficiary got the benefit, or the benefit is a pecuniary thing or it is a kind of personal benefit. The justification of the minister is a type of the jurisprudential interpretation, so it is not binding in Hungary. It is a kind of help for the judicature, so it has a big effect for the judicature, all the same that is not binding.

⁹ Erdősy-Földvári-Tóth: Hungarian Criminal Law Special Part

It is confirmed by the justification of the minister in which the legislative intention is explained.¹⁰ Even so it is confound the law in practice, because it has an opposite aspect. The judicature aspect is that the benefit can be only a pecuniary thing, because the perpetrator intention inetnt for a big profit-taking, or to avoid a price loss. They support this aspect of the construction of the crime, because they say if the insider's breach of duty is intent for other benefits, it is effect a kind of corruption crime.

The other important question is the count of the crime, there are also opposite opinions in this topic. One group states that the count of the crime is defined by the numbers of economic organizations that is concerned by the insider information until they join a company as a stake or shareholder. This state means that use more insider information, or do more transaction it is a natural unit. To reckon with the disposable time for the perpatrator we can exclude cumulatively. The opposite opinion states that the count of the crime is determine by the number of the informations, not by the number of the transactions, do continually transactions with the same insider information it effects cumulatively.¹¹ Naturally we can not define exactly what is that time that is already, or yet enough for determine cumulatively, and this can be diverse in different crimes.¹² The insider transaction is that kind of crime, in which the resulation of the big profit-taking can inspire the perpatrator very much, to use one insider information in a short time to do many transactions with one determination, for the harm of similar investors. For the judicature it is a problem to determine insider information definition, all the same that the Tpt. determine it exactly. The problem is that the definition is contain two not real exact expression. One is the assumption of "not publicized information". The insider is workaround this in the following way: the insider bring out the important information in a website, which is not frequently visited by the investors, the investors usually doesn't get the informations from this website. In this situation we can not impeach the insider because he/she published the information, this information is accesible for everybody, although he/she knows that not too much investor will get that information.

Ideally the insider's intention can not intent to select the investors who are get the information¹³, but it is very hard to prove that what was the intention of the insider.

The definition of price sensitive information is also a problem, it is not sure that in a moment an information what effects in the market.¹⁴ The price sensitivity of the information depends of the activity of the company, and of the function of the company.¹⁵

There is a bigger problem than the above, the lots of insider information, because from these carefulness, not well prepared, trifling, bad habitudes, the belief into the sufficient financial materials, or because in default of ideas in criminal law the information do not get into the criminal investigation authorities.

The other relative problem is to analyze, and to prove of the intention of the accused. Was the kitchen cooking employee be aware that he/she get an insider information when he/she questioned the headmaster of the company? There are some simple case

¹⁰ József Földvári: Hungarian Criminal Law General Part

¹¹ Erdősy-Földváry-Tóth: i.m. 443.o.

¹² József Földvári: i.m. 220.o.

¹³ Mihály Tóth: Economic crimes in the shaping judicature ELTE Law Continuation Istitution

¹⁴ István Vajda: Insider Transaction. Economic Review L. year 2003. March 254. o.

¹⁵ Laura N. Beny: Insider Trading Laws and Stock Markets Around The World: An Empirical Contribution To The Theoretical Law and Economics, John. M. Olin Center of Law and Economics, University of Mitchigan, 2006. 335.o.

when it is easy to decide this, but in most of the cases it is hard task. Because of this, maybe it will be practical to penalize incautious form of the insider transaction., like the Tpt. says in the 201. § (1) section.

The instruments of the National Bank of Hungary in now days are ables to recon effective, and to sanctioning the insider transaction in Hungary, in the last years it was sensible that the cases in insider transaction were multiply. In now days the work of the stock market has traditions. In the form as the insider transaction is in the Hungarian Criminal Code is inopportune to impeach, it is necessary to clear the question of the count of the insider transaction, the benefit snatching, and to solve the problem of the difficulty of prove. It is meritorious to make all these if we are belive seriously that the insider transaction can effect big harms in the economic life in a state.