21. UK insider dealing and market abuse law: strengthening regulatory law to combat market misconduct

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Insider dealing and market manipulation legislation and regulation have been considered necessary to promote the efficient pricing of securities and to enhance the integrity of the capital markets.[1] Insider dealing is not a victimless crime; it is both a manifestation of inefficient markets and a considerable corporate governance problem.[2] Market manipulation involves deliberate acts or statements intended to create false or misleading impressions about a particular issuer(s) of securities or to engage in behaviour that would distort the functioning of the market that could lead to unusual and sharp price swings in securities and related volatility which can undermine investor confidence and financial stability. Both insider dealing and market manipulation have been recognized as criminal offences in all European Economic Area (EEA) countries and in most other jurisdictions with developed financial markets. Moreover, the European Union Directive[3] on Insider Dealing and Market Manipulation requires EU member states to create a civil offence for insider dealing and market manipulation known as the 'Market Abuse' offence.

The chapter analyses the UK criminal law of insider dealing and the civil or regulatory law of market abuse to show how it has evolved and been utilized by UK authorities since the financial crisis of 2007–08 to control market misconduct. Although the substantive law has generally remained the same since before the crisis, UK authorities are increasing the number of investigations and enforcement actions to counter the reputation of the City of London as a 'light touch' jurisdiction that has tolerated market misconduct. Insider dealing is a criminal offence defined under Part V of the Criminal Justice Act 1993. In contrast, market abuse is a civil offence as set forth in §§ 118–123 of the Financial Services and Markets Act 2000. The chapter will review the UK insider dealing law and analyse some related issues concerning the difficulty and complexity of its application. It will then discuss the UK market abuse offence and its development under the EU Directive on Insider Dealing and Market Manipulation.[4] The final section discusses efforts by the UK

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1 See Kern Alexander, Insider Dealing and Market Abuse: The Financial Services and Markets Act (FSMA) 2000, ESRC Centre for Business Research, University of Cambridge, Working Paper 222, 19–20 (2000); see also, Emilios Avgouleas, The Mechanics and Regulation of Market Abuse, 11–14 (2005).

2 Insider dealing laws are generally considered to be necessary because they address a particular manifestation of the principal – agent problem in corporate governance in which firm agents extract rents from the firm by using privileged or confidential information belonging to the firm.

3 Directive 2003/6/EC of the European Parliament and Council of 28 January 2003, *OJ* L96/16.

4 Directive 2003/6/EC of the European Parliament and Council of 28 January 2003.

Financial Services Authority (FSA) to develop a more proactive posture in dealing with market misconduct by using more regulatory enforcement actions to target market abuse.

The regulation of insider dealing under United Kingdom law traditionally had the objective of protecting shareholders against the misuse of privileged or confidential information belonging to the company by corporate insiders who were in a position to utilize the information for their gain at the expense of the company and its shareholders. In contrast, regulatory controls on market manipulation were designed to prevent misleading statements and practices concerning issuers and their securities and behaviour that would distort the markets.[5] The criminal law was the main legal vehicle through which authorities sought to control insider dealing and market manipulation. In recent years, policymakers have recognized that insider dealing and market manipulation also pose risks to the efficient functioning of capital markets and, when complex financial instruments or trading strategies are involved, can lead to serious market distortions and liquidity risks.[6] The EU and its member jurisdictions have adopted the civil or regulatory offence of market abuse requiring a lower standard of proof to impose liability. The market abuse offence is designed not only to protect shareholders against the misuse of proprietary information belonging to the company and others to whom a fiduciary duty is owed, but also to promote a more efficient functioning of financial markets by fostering minimum standards of fair dealing and transparent practices that reduce market distortions and control systemic risks.[7]

In today's globalized financial markets, there is a general acceptance of the impropriety and economic inefficiency of insider dealing and market manipulation. Indeed, the International Organization of Securities Commissions (IOSCO) expressly recognizes market abuse and insider dealing to be a threat to the integrity and good governance of financial markets that can, in certain circumstances, undermine systemic stability in those markets. Accordingly, IOSCO has adopted international standards for the efficient regulation of securities markets that contain recommended prohibitions on market abuse and insider dealing that are designed in part to control systemic risks and enhance financial stability.[8]

[5] See FSMA, 2000, c. 8, § 397 (1) (a)–(c) (containing the criminal offences of misleading statements and misleading practices). The FSA obtained a criminal conviction under § 397 (1)(c) in 2005 against a company and its directors for making a profit forecast to the market which was dependent on three contracts which did not exist. See R. v. Rigby and Rowley (2005) (unreported). Moreover, section 397 (3) defines the criminal offence of market manipulation as engaging in any course of conduct which creates a false or misleading impression as to the market or price or value of relevant investments if that is done for the purpose of creating that impression and of inducing another person to buy, sell, subscribe for, or underwrite those investments.

[6] European Central Bank, Financial Stability Report 2 (January 2011).

[7] Systemic risk has become an important focus of the regulatory reform agenda but its definition has been much disputed by academics and policymakers. See Eilis Ferran & Kern Alexander, The European Systemic Risk Board, 35 Eur. L. Rev. 751–776 (2010).

[8] See International Organization of Securities Commissions, Objectives and Principles of Securities Regulation (2001).

I. THE EVOLUTION OF THE UK INSIDER DEALING OFFENCE

In the United Kingdom insider dealing can be defined as trading in organized securities markets by persons in possession of material non-public information and has been recognized as a widespread problem that is extremely difficult to eradicate. Some of the insider dealing is based on corporate information, i.e. information about a company's finances or operations. In recent years, however, most of the important dealing cases have concerned mergers and acquisitions due largely to the explosive growth in takeover activity during the past decade. Indeed, the bankers, lawyers, public relations advisors and others who receive advance knowledge of proposed takeovers, which invariably occur at a substantial premium over the existing market price of the acquired company's shares, face a strong temptation to make a quick profit from inside information. Moreover, advances in technology have made it possible for traders using electronic trading networks and algorithmic traders to take advantage of privileged inside information and to manipulate markets.[9] Notwithstanding the fact that for over twenty years the abuse of this information has been a serious criminal offence, studies conducted by the FSA indicate that there is considerable evidence that such information is abused in a significant percentage of cases.[10] This indicates that the control of insider dealing is a complex issue in regard to which the criminal justice system can only achieve so much.

The general criminal law has always sought to protect the integrity of public markets. There were very early common law offences that criminalized attempts to interfere with the proper operation of the markets. The possibility of civil liability for breach of fiduciary duty existed for directors and officers who benefited from inside information or who illicitly disclosed privileged information. The scope of action for shareholders, however, was limited because of the rule in *Percival v. Wright*[11] that company directors owed no duties to shareholders. The possibility of civil liability also existed for primary insiders for breach of confidence and for tippees as constructive trustees.[12] Moreover, since the eighteenth century, Parliament and the City of London have adopted a number of measures aimed at promoting the integrity of investment banks, securities brokers and other financial intermediaries.

Although the effectiveness of these measures has been questioned by some economists and market participants,[13] there has always been the recognition that manipulative and fraudulent conduct has especially serious implications for the efficient operation of capital markets because of the threat posed to individual investors. Indeed, maintaining the integrity and fairness of financial markets has generally been viewed as a prerequisite for their efficiency. Yet, the use of information obtained in privileged circumstances has

[9] See Kern Alexander, Market Structures and Market Abuse, in J. Barth and M. Taylor, Safeguarding Financial Stability, the Encyclopaedia of Financial Globalization 120–133 (2012).

[10] See Paul Barnes, Stock Market Efficiency, Insider Dealing and Market Abuse 152–161 (2009).

[11] Percival v. Wright (1902) 2 Ch. 421.

[12] See Brenda Hannigan, Insider Dealing, 8–9 (2nd ed. 1994).

[13] See Henry Manne, Insider Trading and the Stock Market (1966); Jan Engelen & Luc Van Liedkerke, The Ethics of Insider Trading Revisited, 74 J. Bus. Ethics 497 (2007).

not always been considered objectionable, let alone unfair. For example, some economists have suggested that certain restrictions on insider dealing might actually undermine efficiency in financial markets and increase agency problems.[14]

Until 1980, the restrictions on insider dealing in the United Kingdom were extremely limited. There was no specific legislation other than the requirements in the Companies Acts for directors, members of their families and substantial shareholders to report dealings in the shares of their companies. While these disclosure obligations were justified on a number of grounds, a significant one was that this would discourage the abuse of inside information. Whether reporting such transactions does have such an effect is open to debate. In any case, these provisions were poorly policed.[15] We have also seen that the common law provided no real possibility for those who dealt with those who abused inside information to seek recovery in the civil courts.[16] The use of inside information absent some affirmative obligation to disclose it, did not, and probably in most cases still does not, give rise to a cause of action in the civil law. The most significant element of regulation was that provided by a range of self-regulatory and professional bodies in the City of London. For example, the City Panel on Takeovers and Mergers[17] and the London Stock Exchange[18] had adopted rules and guidelines that restricted insider dealing and the 'tipping' of inside information in the early 1970s. There was considerable scepticism, however, as to how effective they were in practice. The self-regulatory bodies in the City of London increasingly recognized that for effective enforcement, particularly where there was an international element in the transaction, statutory powers were required. Consequently, by 1980, many in the City recognized the need for insider dealing to be made a specific criminal offence.

The Companies Act 1980 included the specific criminal offence of insider dealing in limited circumstances.[19] This new criminal offence supported the growing recognition in UK company law that fiduciary duties designed to protect the company and shareholders against insider dealing on the grounds that trading on the basis of inside information was a form of theft from the company and indirectly extracted rents from shareholders was inadequate and that stricter criminal sanctions were needed.[20] The scope of criminal liability for the insider dealing offence was widened under Part V of the Criminal Justice Act 1993 (CJA 1993) by expanding the definition of the terms 'insider' and 'securities'.[21] The CJA 1993 expansion of the offence of insider dealing was enacted as a result of the

[14] See Steven Shavell, Risk Sharing and Incentives in the Principal and Agent Relationship, 10 Bell J. Econ. 55–73 (1979).

[15] See Kern Alexander, et al., Insider Dealing and Market Abuse 31–33 (2002). By contrast, the US enacted anti-market manipulation legislation in 1934 in §§ 9 and 10(b) of the Securities Exchange Act of 1934. 15 U.S.C. 78(i), 78(j).

[16] Percival v. Wright (1902), 2 Ch. 421.

[17] City Code on Takeovers and Mergers, Rule 4.1.

[18] The London Stock Exchange, Model Code for Securities Transactions by Directors of Listed Companies (Yellow Book) §§ 5.43–5.48 (1987).

[19] Part V of the Companies Act 1980 first introduced the offence of insider dealing in certain specified circumstances. See Companies Act 1980, §§ 68–73.

[20] Companies Act 1980, Part V.

[21] Criminal Justice Act 1993, c. 36 (Eng.).

UK Government's implementation of the 1990 European Community Insider Dealing Directive.[22]

The CJA 1993 prohibited three classes of conduct in certain circumstances: (1) dealings in price-affected securities based on inside information; (2) encouraging another to deal in price-affected securities based on inside information; and (3) knowingly disclosing inside information to another. Regarding market manipulation, the Financial Services Act 1986 created two criminal offences consisting of (1) misleading statements, and (2) misleading practices.[23] The traditional UK approach to controlling insider dealing and market manipulation was therefore to use the criminal law,[24] which often proved ineffective in curtailing the rampant abuse of insider information and manipulative practices in UK securities markets.

A. The Criminal Justice Act 1993 (Part V)[25]

The CJA 1993 Part V provides for the offence of insider dealing that seeks to prevent individuals from engaging in three classes of conduct in particular circumstances. First, the Act prohibits dealing in price-affected securities on the basis of inside information.[26] Secondly, it prohibits the encouragement of another person to deal in price-affected securities on the basis of insider information; and, thirdly, it prohibits knowing disclosure of insider information to another.[27] To prove an offence under § 52, it was necessary to demonstrate two elements: (1) the status of the person charged as an insider; and (2) the type of information in the person's possession to be inside information. Section 52 provides in the relevant part:

> (1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.
> (2) An individual who has information as an insider is also guilty of insider dealing if –

[22] Council Directive 89/552 of 13 November 1989 co-ordinating regulations on insider dealing, *OJ* EC 18 Nov. 1989, L 334/30.

[23] FSA, 1986, §§ 47(1) (misleading statements) & 47(2) (misleading practices). The Financial Services and Markets Act 2000 replaced the Financial Services Act 1986. In particular, it replaced § 47 with new provisions prohibiting misleading statements and practices in § 397 (1)–(3) FSMA. See supra note 4 and accompanying text.

[24] As discussed above in note 13, Parliament amended the Companies Act in 1980 to criminalize insider dealing. In 1985 Parliament expanded the insider dealing offence to include tippees by enacting the Companies Securities (Insider Dealing) Act 1985 ('the 1985 Act'). See Companies Securities (Insider Dealing) Act 1985, § 24 (prohibiting individuals who had access to material non-public information by virtue of their position with the company from trading in the company's securities and created a tipping offence and a tippee offence). The UK statutory approach was built on earlier common law offences that criminalized attempts to interfere with the proper operation of the markets, but which created offences that were narrow in scope and thereby difficult for prosecutors to prove in a court of law. Consequently, the 1985 Act resulted in few prosecutions and even fewer convictions.

[25] Criminal Justice Act 1993, c. 36 (Eng.). The CJA 1993 Pt V came into force on 1 March 1994 together with two ancillary statutory instruments (both reproduced in the 'Rules and Regulations'); namely, the Insider Dealing (Securities and Regulated Markets) Order 1994 and the Traded Securities (Disclosure) Regulation 1994. The relevant provisions are in the 'Ancillary Acts.'

[26] CJA 1993 Pt V, § 52(1).

[27] CJA 1993 Pt V, § 52(1) and (2).

(a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or
(b) he discloses information, otherwise than in proper performance of the functions of his employment, office or profession, to another person.
(3) The circumstances referred to above are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary.

Criminal liability for each offence may only attach to an individual because the term 'individual' is defined to exclude corporations and other entities (e.g. public authorities). The definition of individual did cover, however, unincorporated partnerships or firms comprising a collection of individuals. Moreover, it should be noted that a company could be liable for insider dealing by committing the secondary offence of encouraging another person to deal.

To commit the offence of insider dealing, an individual must have information as an insider, which is defined in the CJA 1993 § 57 as follows:

(1) . . . a person has information as an insider if and only if –
(a) it is, and he knows that it is, inside information, and
(b) he has it, and knows that he has it, from an inside source.
(2) For the purposes of subsection (1), a person has information from an inside source if and only if –
(a) he has it through
(i) being a director, employee or shareholder of an issuer of securities; or
(ii) having access to the information by virtue of his employment, office or profession; or
(b) the direct or indirect source of his information is a person within paragraph (a).

The CJA 1993 § 57 created a distinction between a primary insider (a person who has direct knowledge of inside information) and a secondary insider (a person who learns inside information from an inside source). The primary insider usually obtains inside information through being a director, employee or shareholder of an issuer of securities or any person who has information because of his employment or office. A secondary insider obtains inside information either directly or indirectly from a primary insider. Section 57 would impose liability on brokers or analysts as secondary insiders if they act on 'market intelligence' that they know comes from a primary insider.

The insider dealing offence can only be committed if the acquisition or disposal of securities occurs on a regulated market or if the person dealing relied on a professional intermediary or is himself a professional intermediary.[28] The CJA 1993 defines 'professional intermediary' as a person who carries on a business of acquiring or disposing of securities (whether as principal or agent) or a business of acting as an intermediary between persons taking part in any dealing in securities.[29] Individuals employed by such a person to carry out these activities are also defined as 'professional intermediaries'. The

[28] CJA 1993 § 52(3).
[29] CJA 1993 § 59(1)(a).

definition of professional intermediary does not include a person whose activities are merely incidental to other activities or if those activities are only conducted occasionally.[30]

The CJA 1993, § 59 defines 'professional intermediary' as follows:

(1) a professional intermediary is a person –
(a) who carries on a business consisting of an activity mentioned in subsection (2) and who holds himself out to the public or any section of the public (including a section of the public constituted by persons such as himself) as willing to engage in any such business; or
(b) who is employed by a person falling within paragraph (a) to carry out any such activity.
(2) The activities referred to in subsection (1) are –
(a) acquiring or disposing of securities (whether as principal or agent); or
(b) acting as an intermediary between persons taking part in any dealing in securities.

Under this definition, a person will rely on a professional intermediary only if the professional intermediary either acquires or disposes of securities (whether as principal or agent) in relation to the dealing or acts as intermediary between persons taking part in the dealing.[31] If deals in securities do occur on a regulated market (i.e. investment exchange), the insider dealing offence will be relevant unless the transaction is truly a private deal off the market without the intervention of a market professional.

The offence of insider dealing cannot apply to anything done by an individual acting on behalf of a public sector body in pursuit of the government's economic policies (e.g. managing monetary policy through the adjustment of exchange rates, interest rates or the public debt or foreign exchange reserves).[32] The purpose of these exclusions is to permit government policymakers to have sufficient discretion to manage the economy in the public interest. These exclusions, however, would not apply to the government's sale of shares in a privatization.[33]

B. The Elements of the Dealing Offence

The two essential requirements for the dealing offence are that: (1) an individual must have information as an insider; and (2) the insider must deal in securities that are price-affected securities in relation to the information.[34] With respect to inside information, the prices of price-affected securities will likely be significantly affected if information related to such securities is made public.[35] Accordingly, if an insider has inside information, he must not deal in the securities to which that information relates. The CJA 1993 adopts a broad definition of 'dealing in securities' to cover any acquisition or disposal of a security, including an agreement to acquire or dispose of a security and the entering into a contract

[30] CJA 1993 § 59(3)(a)–(b).
[31] CJA 1993 § 59(4).
[32] CJA 1993 § 63(1).
[33] These exclusions would not apply or exempt the setting of the London Inter-bank Offered Rate ('LIBOR'), which is calculated daily based on estimates by large banks of their cost of borrowing funds in fifteen different currencies in the inter-bank loan market.
[34] CJA 1993 § 52(1).
[35] CJA 1993 § 56(2).

which creates the security or the bringing to an end of such contract.[36] Moreover, such acquisitions or disposals are within the definition irrespective of whether they are made by an individual as principal or as agent.

The securities to which the Act applies are price-affected securities which are defined in the CJA 1993, Schedule 2. They include shares and debentures in companies, as well as their derivatives. They also include gilts and local authority stock (even of foreign public bodies) and their derivatives. Contractual rights for difference (e.g. derivatives) are also included. The list conforms to the EC Directive on Insider Dealing,[37] so that not only corporate securities and instruments based on such securities are included, but also that other contractual rights in other futures and derivatives markets are covered.

The relevant time at which to consider whether or not an offence has been committed would appear to be at the time of agreement to acquire or dispose of the security. At that time, if the individual had inside information about these securities he will have committed an offence. However, if he received inside information only after making the agreement, he will probably not have violated the provision if he completes the deal and actually acquires or disposes of the securities. On the other hand, if the individual had the inside information at the time when he agreed to acquire or dispose of the security, it would seem that he will still have committed an offence, even if he does not complete the bargain.

The acquisition or disposal may be made by an individual acting either as principal or agent. Accordingly, if an agent has inside information, he will be within the scope of the offence if he deals in the relevant securities even though, in a direct sense, he will not gain from the transaction. This has special relevance to a trader who is engaged in a transaction as agent to benefit his principal. The fact that the individual deals as agent and not principal is irrelevant. However, where the agent deals on an execution basis only, such an approach hardly seems justified and is unfair to the principal who gave the instruction if the agent then feels inhibited from processing the order. Fortunately, it appears that a defence in this situation would allow the agent to act on instructions notwithstanding that, incidentally, he has inside information.[38]

A person is also regarded as dealing in securities if he procures, directly or indirectly, an acquisition or disposal of the securities by another person.[39] Such procurement may occur in a number of ways, including where the person who actually acquires or disposes of the security is acting as an agent, nominee or at the direction of another in relation to the acquisition or disposal of a security.[40] This aspect of the definition of 'dealing in securities' is designed to cover transactions through an agent or nominee where the principal has relied on inside information without purchasing or selling the securities himself. Transactions are also covered that are undertaken at the direction of a sole shareholder who uses its influence over a company to deal in its shares.[41]

The buying or selling need not necessarily relate to securities of the company with

36 CJA 1993 §55(3)(b).
37 Art. 1(2) Council Directive 89/552/EEC.
38 CJA 1993 § 53(1)(c).
39 CJA 1993 § 55(1)(b).
40 CJA 1993 § 55(4).
41 *See* Parliamentary Debates, House of Commons, Standing Committee B, 10 June 1993, column 171 (per the Economic Secretary).

which the person concerned is in an access relationship. It is also the case that dealing in the securities of related companies on the basis of relevant unpublished information would also be considered insider dealing. Dealings in securities other than equity securities that are price-affected by the information would be considered to be insider dealing in the UK and most other jurisdictions. Thus, acquiring options to acquire or dispose of underlying securities would be objectionable, as would dealing in other types of derivative securities. The question is simply whether the decision to deal in the relevant securities is influenced by the information that the person concerned has acquired and is using improperly.

The term 'insider dealing' is wide enough to encompass deals on or off an organized securities market. While a number of legal systems have effectively confined the operation of their legal rules to transactions that occur on an organized securities exchange or on or through an organized over-the-counter market, the elements of the abuse are the same whether the transaction is on a market or in a private direct transaction. One of the reasons why jurisdictions have confined the operation of their laws to public markets is the idea that the wrong indicated by insider dealing is one against the market as a whole. It saps confidence in the integrity and fairness of the market. Consequently, some countries have made available only their criminal laws to sanction this essentially public wrong or, rather, crime. Off-market transactions are left to the ordinary law that governs the commercial dealings of private persons. The fallacy is to attribute the description of insider dealing to one type of transaction and not to the other. While there may be justifications for distinguishing market and off-market insider transactions in regard to the remedies that are made available and in relation to enforcement, the nature of the abuse and its elements are the same. Therefore, it is appropriate to regard insider dealing as taking place on organized markets as well as in private and even face-to-face transactions.

Regarding the case of primary insiders, the classic example that is often given of insider dealing is where a director of a company learns in a board meeting that his company's profit forecasts are about to be revised to a significant extent and then goes onto the stock market and trades on the basis of this information before it is made publicly available. In such circumstances, he has clearly taken advantage of his position and the information that came to him by virtue of his seat on the board. He has manifestly misused the confidential information that was entrusted to him in the proper performance of his duties as a director or, in the words of US federal law, misappropriated it. It would also be generally regarded as falling within the notion of insider dealing if he persuaded another person to deal in the securities of his company or disclosed the information to a third person knowing that he would be likely so to deal or otherwise misuse the information.

In the case of other primary insiders, it is not, of course, only company directors that will in the ordinary course of their duties acquire price-sensitive information. Indeed, it is probably more likely that in most companies there are many other insiders who will come into possession of such information rather more regularly than the directors. Having regard to the obvious relationship that a director has to his company, it remains to be seen whether such persons would be rash enough to risk exposure to public criticism by engaging in insider dealing. Furthermore, it cannot be taken for granted that most company directors would be willing to risk their position and the financial and other benefits that arise as a result of their office by engaging in abusive deals.

The notion of insider dealing is broad enough to encompass all those who, by virtue of their position in the company or who, by their business or professional relationship with the company, are likely to have access to privileged information. For the sake of convenience, it is perhaps useful to describe such persons as primary insiders. They are all subject to the common denominator of enjoying a special relationship with the company that gives them access to the price-sensitive information in question. Indeed, in US jurisprudence, they have often been referred to as 'access insiders'. Debate has taken place as to whether those who obtain such information in breach of their duties attaching to the relationship in question should be regarded as primary insiders. For example, is it appropriate to regard an office cleaner, who, while having access to a company's premises by virtue of her employment directly or indirectly with the company, obtains price-sensitive information by rummaging in the rubbish bins, as a primary insider? Although it is arguable that all those who abuse price-sensitive information should be sanctioned, for the sake of convenience in drafting rules and laws, most jurisdictions distinguish between those who obtain such information in the proper and lawful exercise of the duties attaching to the relationship that they have with the relevant company and those who do so essentially outside the scope of those responsibilities.

Regarding secondary insiders, it is also considered to be insider dealing when a person, while not in an access relationship to the issuer, acquires the relevant information in circumstances where he knows that it is unpublished price-sensitive information and comes from an insider source and then deals or encourages another to deal. Thus, although the office cleaner in the example referred to above might not be considered to be a primary insider, her abuse of the information obtained from what she appreciates is an 'inside source' would generally be considered to amount to insider dealing. In some cases, it will even be considered objectionable for this tippee or secondary insider to pass the information on to yet another person in circumstances where they know or should appreciate that the information is likely to be misused.

Regarding inside sources, the law and, indeed, morality in most societies necessitates proof of a relationship between the source of the information and the person who is to be accused of insider dealing. The price-sensitive information must be obtained by virtue of this relationship. It is the relationship that taints it and renders improper its use for personal benefit. Of course, the notion of relationship is stretched far beyond what the law would normally consider to be relationships of a fiduciary quality or, for that matter, necessarily giving rise to a duty of confidentiality. The extent to which it is necessary to establish that the relevant information is obtained by virtue of the privileged access that the relationship gives to the person concerned is a matter for debate. Logically, if the information can be shown to have been obtained from some other and outside source, then its use by a person who is clearly in a special relationship with the company should not be considered to be insider dealing. However, in most systems of law, there will be a 'presumption' that if a primary insider is in possession of price-sensitive information in regard to the securities of the issuer with which he has an access relationship, then the 'inside information' was obtained pursuant to this relationship.

In considering the definition of inside information, one should accept the premise that information itself is a very vague and ill-defined concept in most legal systems. However, in the context of insider dealing, it is generally not necessary to refine a definition that does more than indicate that it possesses a quality sufficient to influence the decision of the person who has access to it to deal in particular securities. In other words, the informa-

tion that the person accused of insider dealing has in his possession must be such as would influence his decision to buy or sell. In the UK, as in most legal systems, it is enough if the information would influence the mind of a person who would be likely to deal in the relevant securities. Thus, materiality is objective and is determined by reference to the particular class or group of investors that would ordinarily be likely to deal in the securities in question. This gives the test of materiality sufficient flexibility to accommodate narrow and highly specialized markets. The more specific and precise the information is, the more likely it is that it will influence the mind of a reasonable person.

The information must be inside information. In other words, it must have a quality that ties it to the issuer in whose securities the dealing takes place. We have already discussed this issue in terms of the relationship that the person accused of insider dealing must have, directly or indirectly, with the source of the information. Obviously, relevance will be bound up with materiality in most conceivable cases. The information need not be generated within, by or for the benefit of the issuer in whose securities the dealing takes place. For example, it would be objectionable for a director of a company that intends to make an attractive takeover offer for the securities of another company to deal in the securities of that other company on the basis of this knowledge. The information in such a case may be regarded as being inside information obtained through his insider nexus with his company, but its relevance is to the market in that other issuer's securities.

While the information involved in most cases of insider abuse will be confidential or at least obtained in a relationship that might be expected to give rise to obligations of confidentiality, it is not always that the information will be such that could be protected as 'confidential' information. Indeed, there will be cases where the information is too tentative to be protected as proprietary information, but which would still meet the test of materiality. It is also the case that there will be situations when the information is not confidential to a particular person or entity. In the result, it is clear that inside information is not always confidential information. Of course, in the United States, the courts have fashioned the so-called 'misappropriation theory' to justify liability for insider dealing. This approach sanctions the 'misappropriation' of information that belongs to another person. Dealing on the basis of such information will constitute a misappropriation, as will improperly disclosing it to another in circumstances where that other utilizes it. The notion that information belongs to another person who will often obtain the same by the inside source is a difficult one for many legal systems. For example, while many legal systems are prepared to protect confidential information as if it were a form of property, not all by any means consider information capable of being a species of property.[42]

Regarding unauthorized disclosures, it has already been pointed out that most systems of insider dealing regulation would regard disclosing inside information to another person, without the appropriate authority, in circumstances where that other person is likely to abuse the information, as a form of insider dealing. Of course, merely disclosing information, even if there is an expectation that the recipient will himself deal, is not 'dealing' in any real sense of the word. While it is possible and commonplace to attribute the transactions of an agent to the principal and therefore the deals of the agent to the

[42] See, e.g., Oxford v. Moss (1978) 68 Cr. App. R. 183 (holding that information was not property for the purpose of the law of theft).

deals of the 'insider', it is less easy to describe procuring or encouraging the dealing of another as insider dealing. Nonetheless, the term 'insider dealing' is often employed in such an expansive manner, as it is in the UK.

Where a person, without authority, discloses unpublished and material information in the knowledge that the recipient might well utilize the information for dealing, then it is at least arguable that the person should be held responsible for what is indirectly the exploitation of the information in question. In the UK, as in most systems of law that regard such unauthorized disclosures as tantamount to insider dealing, it matters not whether the recipient actually engages in transactions which would themselves be considered insider dealing. For example, while the informant might be culpable, the recipient who deals on the basis of the information may not be aware that the information emanates from an inside source. Of course, a failure to appreciate the status of the information might well in any case bring into issue its materiality.

Such conduct will, however, only be considered objectionable when the primary insider discloses the relevant information without proper authority. It is not always easy to decide if a particular disclosure is legitimate or not. As a general rule, if the disclosure is made with the actual or implied authority of the person concerned to make or authorize disclosure, then it will not be objectionable. There may be cases where, while the relevant officer of the company has authority to disclose information, he does so not for a proper purpose, but perhaps to facilitate improper transactions on the part of another. In most systems of law, agents have authority only to engage in actions that are properly motivated. Therefore, a disclosure that is motivated by improper considerations, such as a desire to promote a false market, would not be legitimate and justifiable even when a primary insider has no authority to disclose information. It may well be on the facts appropriate and legitimate for him to do so, for example 'blowing the whistle' on misconduct. Provided that such is done for a purpose that would be considered proper and is not dishonest, it is hard to see that such conduct could be described as fostering insider abuse. The line between what is acceptable and what is not is not always clear. Difficulties have arisen in the case of selective disclosures to analysts and private briefings, as we shall see in the discussion of the market abuse offence.

Section 402 of the Financial Services and Markets Act 2000 authorizes the FSA to enforce the criminal offence of insider dealing.[43] Over the years, responsibility for prosecuting crimes involving insider dealing has proved to be something of a 'hot potato' and has been shared by several UK agencies and prosecuting authorities. The police have never been particularly enthusiastic about such cases and the Serious Fraud Office has taken the view that the vast majority would not come within its statutory remit. Indeed, several years ago the SFO dismissed such offences as being of a 'technical and regulatory' nature. With the realization that 'real' criminals may engage in the deliberate gathering and exploitation of price-sensitive information attitudes have possibly changed, and even the Serious Organized Crime Agency has exhibited some interest. However, given the FSA's exclusive responsibility for policing the market abuse regime it is sensible that the FSA is now the lead prosecutor for cases under the Criminal Justice

[43] See Financial Services and Markets Act 2000, c. 8 (Eng.), § 402 (authorizing FSA to bring insider dealing prosecutions and imposing seven year custodial sentence for insider dealing).

Act.[44] It should be remembered, however, that serious cases of insider abuse will often involve other criminal conduct and more general offences, such as money laundering and terrorist financing.

II. THE MARKET ABUSE OFFENCE

In 2000, the UK Parliament enacted the Financial Services and Markets Act 2000, which created a civil offence for market abuse, enhanced criminal penalties for insider dealing, and created three criminal offences for misleading statements and practices.[45] Section 118 FSMA created three distinct categories for the market abuse offence: (1) misuse of information; (2) creating false or misleading impressions; and (3) market distortion. Unlike the above criminal offences, the market abuse offence could be enforced in regulatory administrative proceedings in which unlimited civil penalties could be imposed based on a lower evidentiary standard defined as the regular user test. Significantly, the market abuse offence was concerned not only with protecting legally privileged information belonging to issuers of securities against abusive behaviour by insiders and other third parties, but also was directed against behaviour that could undermine market confidence, including systemic stability. The market abuse offence was designed therefore to enhance market confidence and investor protection by prohibiting *any* person – not just insiders who owed a duty to corporate issuers not to benefit from the use of inside information – from misusing information (i.e. legally privileged information), or creating false or misleading impressions in the market, or distorting the market concerning qualified investments traded on recognized exchanges. By defining the offence in broad terms, the regulatory authority could police the market for behaviour that was not only abusive to particular issuers, but to the market as a whole. As discussed below, the EU Market Abuse Directive 2003 has required the UK to elaborate the definition of market abuse in key areas.

A. What Constitutes Market Abuse

In contrast to the criminal offence of insider dealing, the statutory framework creating the market abuse offence is very broad, covering 'behaviour' that is both on market and off market, including trading activity and disseminating false or misleading information. The Market Abuse Directive extended the three categories of market abuse under the original § 118(2)(a)–(c) – misuse of information, creating false or misleading impressions, and market distortion – to seven categories as set forth in § 118(2)–(8):

[44] The FSA has so far secured eleven further convictions in relation to insider dealing: Christopher McQuoid and James William Melbourne in March 2009; Matthew and Neel Uberoi in November 2009; Malcolm Calvert on 11 March 2010; Anjam Ahmad on 22 June 2010;Neil Rollins on 21 January 2011; Christian and Angie Littlewood on 8 October 2010; Helmy Omar Sa'aid on 10 January 2011; and Rupinder Sidhu on 15 December 2012. As of July 2012, the FSA is prosecuting eleven other individuals for insider dealing.

[45] FSMA, 2000, §§ 118–123 (Market abuse regime), and § 402 (authorizing FSA to bring insider dealing prosecutions and imposing seven year custodial sentence for insider dealing); and § 397 (1)–(3) creating three criminal offences for making misleading statements and acts.

(1) insider dealing; or
(2) improper disclosure of inside information; or
(3) misuse of relevant information where the behaviour falls below the standard of behaviour reasonably expected by a regular user of the market or a person in the position of the alleged abuser; or
(4) manipulating transactions in the relevant market unless for legitimate reasons and in conformity to accepted market practices on the relevant market; or
(5) manipulating devices; or
(6) information dissemination that gives or is likely to give a false or misleading impression; or
(7) misleading behaviour or distortion of the market where the behaviour falls below the standard of behaviour reasonably expected by a regular user of the market or an alleged abuser;
unless such behaviour conforms with a rule which expressly provides that behaviour which conforms with the rule will not amount to market abuse; or conforms with Commission Regulation 2273/2003/EC which implements the Market Abuse Directive in relation to exemptions for buy-back plans and stabilization of financial instruments; or does not amount to market abuse under the Code of Market Conduct, or some other FSA position.

In addition, the UK regime maintains its separate civil offence of requiring or encouraging another to commit market abuse if the act in question would have amounted to market abuse if committed by the requirer or encourager.[46] It states in relevant part that the requirement or encouragement offence can be committed if 'by taking or refraining from taking any action, a person has required or encouraged another person or persons to engage in behaviour which if the person themselves engaged in such behaviour would amount to market abuse'.[47] In considering whether to bring an action for this offence or the market abuse more generally, the FSA will take account of factors such as acceptable market practices and level of knowledge and skill of the person concerned.

B. Prescribed Markets, Qualifying Investments and the Jabre Case

The FSA enforcement action against the hedge fund manager Phillipe Jabre and his employer GLG Partners raised an important issue regarding the scope of the term 'qualifying investments'. In the *Jabre* case,[48] the defendant Jabre had entered into agreements to short sell the stock of the Japanese bank Sumitomo Mitsui Financial Group (SMFG) a few days after receiving price-sensitive information about the bank from a Goldman Sachs salesman. Jabre argued that his conduct in short selling SMFG stock was not, as a matter of law, market abuse contrary to § 118 because his trades in SMFG shares occurred on the Tokyo Stock Exchange and therefore were not qualifying investments on a prescribed market. He argued that it would violate the 'territoriality' principle for a market

[46] FSMA 2000, § 123 (1)(b) (authorizing the FSA to impose a penalty on a person if it is satisfied that that person, by taking or refraining from taking any action, has required or encouraged another person or persons to engage in behaviour which, if engaged in by the encourager, would amount to market abuse.

[47] Id.

[48] Jabre v. Financial Services Authority (Jurisdiction) [2006], Court of Appeal – United Kingdom Financial Services and Markets Tribunals, 10 July 2006 (Eng.) (hearing on appeal by Mr. Jabre of the Financial Service Authority's Decision Notice to Philippe Jabre and to GLG Partners (28 February 2006)).

abuse penalty to be imposed in the exercise of the FSA's power under § 123. The FSA found, however, that Mr. Jabre's behaviour did occur in relation to qualifying investments (SMFG shares) that were traded on a prescribed market. SMFG's shares were qualifying investments of a corporate body (SMFG) and, crucially, those shares were quoted at the relevant time on the London Stock Exchange's SEAQ International Trading System, which was a market to which § 118 applied.[49] Jabre contended that the actual shares he shorted were not traded by him on the London market, but rather on the Tokyo market, and that the term 'qualifying investments' applied only to the shares actually traded, and not to all the shares of the same kind. Moreover, he argued that the purpose of § 118 (prior to the Market Abuse Directive) was to regulate conduct in relation to UK markets, and not in respect of markets outside the UK which were not prescribed by the UK Treasury; and that his conduct on the Tokyo market had no effect on the shares listed on the London market and therefore could not constitute market abuse simply because the shares in question were listed on both markets.

The Tribunal rejected this argument by reasoning that the statutory phrase 'traded on a market to which this section applies' in subsection (1)(a) does not mean that the actual shares traded had to be the same shares that were subject to the abusive behaviour. The Tribunal held that behaviour constituting market abuse 'does not require the identification of any particular shares as being the qualifying investments to which the behaviour relates'. Indeed, the Tribunal reasoned that, if Jabre's argument were accepted, it would be nearly impossible for a regulator in market abuse cases involving, for example, disclosing inside information or disseminating false rumours, to identify any particular share or group of shares which were the subject of wrongful behaviour. Moreover, Jabre's assertion that his conduct on the Tokyo market did not have an effect on the London market was inapposite because the real issue was whether Jabre's behaviour on the Tokyo market could be reasonably expected to undermine confidence in the shares traded on the London market. The Tribunal held that Jabre's insider dealing by shorting the shares of the Japanese bank, wherever it occurred, had the effect of destroying confidence in the global market for the bank's securities and therefore constituted market abuse with respect to qualifying investments on UK prescribed markets.

C. The Duty to the Market

The *Jabre* case also highlights the duty of market participants to the market to maintain transparency and overall market confidence. An important aspect of the market abuse offence was that, unlike the criminal offence of insider dealing, it established a duty to the market for anyone whose conduct – whether on or off market – was defined as being market abuse. This meant that it was not necessary for prosecutors to prove that the defendant breached a duty to an investor or to the company or firm whose financial

[49] The Tribunal observed that SEAQ International (the Stock Exchange Automatic Quotation System for international equity market securities) is a quote-driven trading service in which securities traded on SEAQ International required at least two market makers registered with the London Stock Exchange and that two-way prices must be displayed on the LSE system for the security in question. SEAQ International was a prescribed market because of its link with the LSE, and SMFG's shares, which were listed on the LSE system through SEAQ, were qualifying investments.

instruments were being traded. It was sufficient for the regulator to show on a balance of probabilities that the behaviour in question in respect of qualifying investments had impacted the market itself by undermining investor confidence and the integrity of the market as perceived by regular users of the market. In imposing liability, however, the FSA may still under certain circumstances need to show that the state of mind of the alleged abuser was relevant for committing the offence.

Market abuse is therefore defined as behaviour which occurs in relation to qualifying investments admitted to trading on a prescribed market, or in respect of which a request for admission to trading has been made. It also applies to qualifying investments and to investments that are related to qualifying investments. These related investments can be traded on exchanges that are not prescribed UK exchanges. For instance, related investments could be traded on prescribed exchanges or off exchange in other EEA jurisdictions, or on or off exchange outside the EEA, if they relate to qualifying investments on a UK prescribed market. Although relevant in some circumstances, the state of mind of the market abuser is not necessarily relevant for a successful prosecution of the civil offence.

III. EU INSIDER DEALING AND MARKET MANIPULATION DIRECTIVE

The EU Insider Dealing and Market Manipulation Directive[50] has defined insider dealing as a form of market abuse that can constitute both a civil and a criminal offence. The Directive expands the scope of personal liability for primary insiders by excluding any requirement that they have 'full knowledge of the facts' in order for criminal or civil liability to be imposed. The repeal of this requirement recognizes the market reality that primary insiders may have access to insider information on a daily basis and are aware of the confidential nature of the information they receive. In addition, the Directive adopts an information connection requirement to the definition of secondary insider.[51] According to this definition, a secondary insider would be any person, other than a primary insider, 'who with full knowledge of the facts possesses inside information.' They would be subject to the same prohibitions on trading, disclosing and procuring as primary insiders.

The UK regulations implementing the Directive replace the original § 118(2)(a)–(c) with new definitions of who are the 'insiders' and of what constitutes 'inside information'. Rather than having three definitions of abusive behaviour in § 118, there are now seven categories which provide more specific definitions of prohibited or restricted behaviour.

[50] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] *OJ* L96/16.

[51] Directive 2003/6/EC, Article 2 (prohibiting 'any person . . . who possesses inside information from using that information by acquiring or disposing of, or by trying to acquire or dispose of, . . . either directly or indirectly, financial instruments to which that information relates'), and Article 4 (prohibiting 'any person', . . . 'who possesses inside information while that person knows, or ought to have known, that it is inside information' from disclosing inside information to any other person). See EC Market Abuse Directive [2003], *OJ* L96/21, Arts 2, 3 and 4.

This includes 'behaviour' 'where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question'. By § 118A, behaviour is taken into account only if it occurs 'in the United Kingdom' or is taken outside the UK with respect to a qualifying investment (or related investment) on a prescribed UK market or a qualifying investment (or related investment) on a market prescribed by another EEA state. This provides extraterritorial jurisdiction for the FSA or other EEA authorities to enforce their market abuse legislation against parties who engage in behaviour outside their territory that amounts to market abuse if it relates to qualifying investments on prescribed markets in an EEA member state.

Section 118B defines 'insiders' as any person who has inside information, among other things, 'as a result of having access to the information through the exercise of his employment, profession or duties'. The term 'insiders' also applies to any person who has inside information as a result of his membership of the administrative, management or supervisory bodies of an issuer of qualifying investments, or as a result of his holding in the capital of an issuer of qualifying investments, or as a result of his criminal activities, or obtained by other means and which he knows, or could reasonably expect to know, is inside information.

Section 118C defines 'inside information' for the purposes of Part VII of the Act as the following:

> (2) In relation to qualifying investments, or related investments . . . inside information is information of a precise nature which –
> (a) is not generally available;
> (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments; and
> (c) would if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of the related investments . . .

This broad definition of 'inside information' derives from the Directive's definition of inside information as 'precise, not been made public, relates directly or indirectly to issuers, and if made public, would have a significant effect on price of qualifying investments (i.e., financial instruments actually issued by the issuer)'. Information is regarded as generally available to users of the market if it can be 'obtained by research or analysis conducted' by or on their behalf.

The EU Market Abuse Directive's broader definition of inside information has reinforced the powers of the FSA to bring market abuse cases based on misuse of information and privileged or confidential information that is leaked by insiders. This was demonstrated in the FSA's enforcement action in 2008 against Richard Ralph and Philip Boyens. This case showed how insiders who acquire inside information in relation to their professional and employment duties can be subject to civil liability for market abuse.[52] In this case, Mr. Ralph, a former UK Ambassador to Belgium, was, at the relevant time, the executive chairman of AIM-listed, Monterrico Metals plc (Monterrico) when he asked

[52] FSA Notice to Richard Ralph (12 November 2008/Ralph); and FSA Notice to Philip Boyen (12 November 2008/Boyen).

Mr. Boyen to buy £30,000 ($46,500) worth of shares on his behalf. At the time, it was public information that the company was in takeover talks, but Mr. Ralph also knew that a takeover had been agreed in principle at a premium price that substantially exceeded the then share price. Mr. Ralph was involved in the takeover discussion and knew he was not allowed to deal in the company's shares while the material information on the takeover had not been disclosed. He nevertheless directed his broker to execute trades on his behalf before the material inside information was disclosed.[53]

IV. POST-CRISIS FSA ENFORCEMENT

The UK Financial Services Authority was criticized in several government reports and by the House of Commons Treasury Committee for following a 'light touch' prudential regulatory approach and for failing to investigate and enforce effectively investor protection, market abuse and insider dealing rules before the global credit crisis began in 2007. Between 2003 and 2007, the FSA brought only nine enforcement actions for market abuse and insider dealing. After the crisis began, however, since 2007 the FSA has toughened its approach considerably by embarking on a number of high profile investigations, including pre-dawn raids on banks and investment firms, and increasing the number of enforcement actions against those accused of market abuse or insider dealing. For example, the FSA has averaged since 2008 fifteen enforcement actions a year involving alleged market abuse and has imposed over £214 million ($331.4 million) in civil fines.[54] Regarding the criminal offence of insider dealing, it has obtained eleven convictions and prosecuted an additional sixteen cases in 2012. Indeed, the FSA's enforcement approach has become more aggressive in order to send a message to the market that market misconduct will not be tolerated and it has enhanced its co-ordination in cross-border prosecutions with foreign regulators.[55] This was demonstrated in the case against James and Miranda Sanders, which resulted in the FSA obtaining convictions in May 2012, when these British defendants were convicted for illicitly using inside information about US issuers to trade index futures on a London exchange.[56]

The FSA's stricter approach was demonstrated in several highly publicized cases in 2011 and 2012 involving senior bankers and fund managers who allegedly leaked insider information on UK-listed companies in violation of the UK market abuse regime. Specifically, the FSA imposed a civil penalty of £450,000 ($725,000) on Ian Hannam,

[53] See FSA Notice to Richard Ralph (12 November 2008/Ralph); and FSA Notice to Philip Boyen (12 November 2008/Boyen). Ralph agreed to a fine of £117,691.41, while Mr. Boyen agreed to a fine of £81,982.95.

[54] See supra note 44 and accompanying text.

[55] In the recent FSA insider dealing enforcement action against James and Miranda Sanders, FSA acting director of enforcement and financial crime, Tracy McDermott, said that the FSA is sending 'a clear message about our willingness, and ability, to tackle serious, organised insider dealing'. In cases involving cross-border investigations and enforcement, the FSA acting enforcement director has observed that the FSA 'and our overseas counterparts, are committed to working together to tackle abuse wherever it occurs'. See http://www.fsa.gov.uk/library/communication/pr/2012/060.shtml (last accessed 8 October 2012).

[56] Id.

JP Morgan Chase's global head of equity capital markets, in April 2012 for illicitly disclosing inside information to a third party investor about the likelihood of a takeover of a company by one of Mr. Hannam's clients. Mr. Hannam has appealed the penalty to the UK Financial Markets Tribunal on the grounds that the information he disclosed was not privileged inside information and that he did not make a profit or avoid a loss personally on the leaked information. Nevertheless, the UK Listing Authority has strict prohibitions on insiders leaking inside information to third parties outside of approved reporting channels. This type of unauthorized disclosure of inside information constitutes misuse of privileged information, a form of market abuse which, although it may not be criminal insider dealing, is a civil offence for which unlimited fines can be imposed.

The other high profile case involves prominent investment manager David Einhorn[57] and his hedge fund Greenlight Capital,[58] which together were fined £7.2 million for trading on the basis of confidential information in the shares of a British pub chain. In this case, Mr. Einhorn and Greenlight Capital traded on the basis of inside information about a UK listed company. Mr. Einhorn denied wrongdoing by arguing that he committed the trades in question in New York and that he did not fully understand the breadth of the market abuse offence. He decided not to appeal the FSA's decision and to pay a settlement.[59]

The FSA enforcement approach aims to expose and deter market abuse which has been rife in UK financial markets for many years. Prior to 2007, many traders in the UK markets were aware that the benefits of engaging in market abuse and insider dealing, such as passing on inside information, far outweighed the potential costs of being caught, in part because the penalties were low and enforcement unlikely. However, after a number of parliamentary hearings that exposed the FSA's passive posture as a supervisor, the FSA has taken on a more proactive stance in enforcing prudential regulation and conduct of business rules. As discussed, this has resulted in increased enforcement of market abuse and insider dealing laws. The FSA, however, will be disbanded in 2013 as new UK legislation that restructures financial regulation will take effect. The FSA will be replaced by a Twin Peaks regulatory model consisting of a Prudential Regulatory Authority (PRA), whose responsibility will be to supervise financial institutions, and a Financial Conduct Authority (FCA), whose responsibility will be to protect investors and consumers and enforce conduct of business rules. Under the Financial Services Act 2013, the FCA will be the primary enforcer of the UK market abuse regime and insider dealing laws. Most of the FSA's enforcement and market conduct divisions will be transferred to the FCA, where it is expected that the tougher enforcement will be continued.

The FSA's efforts to strengthen regulatory controls and enforcement against market misconduct have come in for criticism by industry practitioners and their lawyers and

[57] See FSA Decision Notice to David Einhorn (12 January 2012). The FSA imposed a fine of £3,638,000 for engaging in market abuse in violation of § 118(2) FSMA.

[58] See FSA Decision Notice to Greenlight Capital, Inc. (12 January 2012). The FSA decision imposed on Greenlight Capital, Inc. a fine of £3,650,795, pursuant to § 123(1) of FSMA for engaging in market abuse in violation of § 118(2) FSMA.

[59] FSA Decision Notice, supra note 57.

by some politicians.[60] The case involving Ian Hannam has attracted much controversy because it involves a banker accused by the FSA of misuse of information (the market abuse civil offence) even though he was not alleged to have made a profit or avoided a loss by trading on such information. Moreover, the case involves the definition of insider or privileged information and the burden of proof that the FSA is required to meet in a civil action to establish that the information is inside information. Also, the FSA has used new powers provided under the Financial Services Act 2010 to ban financial professionals found liable for market abuse or other market misconduct.[61]

These cases demonstrate that the UK and EU securities laws have a broader definition of market misconduct that would violate the market abuse rules whereas similar conduct under US securities laws may not attract liability. For example, the definition of what constitutes insider information under US criminal law must be proved beyond a reasonable doubt and the defendant is entitled to a jury trial. By contrast, under the UK market abuse regime, what constitutes inside or privileged information need only be proved on the balance of probabilities (more likely than not) and the case would be heard before an administrative tribunal. Under UK law, one type of market abuse could be the sharing of information that later turns out to be significant or market moving, but at the time of the leak did not appear to the insider who leaked the information to be market moving. The FSA would only have to prove on the balance of probabilities that the accused knew or should have known that the information was inside or privileged information and therefore could only be disclosed lawfully to a third party through approved regulatory channels. Lawyers advising market professionals have complained that this has created ambiguity and uncertainty regarding what they can or cannot disclose to clients or other third parties. Indeed, some have observed that the FSA Handbook rules are not clear and that the FSA is not providing adequate guidance to market practitioners about what they can and cannot disclose. This ambiguity, however, in defining new and untested areas of conduct as market abuse, is part of the FSA's new approach to stricter regulation that is judgment led and forward looking.[62] The FSA's judgment-led supervisory and regulatory approach aims to strike a balance between a legalistic rules-based approach of defining what is and what is not market misconduct with a more forward-looking approach that grants discretion to the supervisor to use its judgment to respond to changes and innovations in the marketplace that might constitute a new form of market abuse but have not yet been defined as such by the regulator in its rulebook. This proactive, forward-looking and judgment-led approach to regulation has become official policy of the UK Treasury and is an overriding theme in the Financial Services Act 2013, which replaced the FSA with the PRA and FCA in early 2013.

[60] See Allister Heath, Murdoch and Hannam's Departures Symbolise Power Shift, City AM, 4 April 2012, at 2 (British MP David Davis criticized the FSA market abuse enforcement action against Ian Hannam as 'un-British' and that the regulator's disciplinary process was against traditional principles of English law and that the offence of misuse of information charged by the FSA was an 'incredible extension of what constitutes insider trading by the FSA').

[61] Several recent FSA decision orders imposing substantial penalties and banning orders are under appeal (including the appeals of two traders from Cantor Fitzgerald who appealed their fines and banning orders in early 2012) and will be ruled on in late 2012 by the Upper Tribunal.

[62] See Hector Sants, Financial Services Authority Chief Executive Officer, Oral Evidence before the UK Parliament's Joint Committee on the Draft Financial Services Bill (11 November 2011) at 17–18.

It is generally accepted among market practitioners that before the FSA adopted this more proactive regulatory approach, market participants had rarely been charged with market abuse, let alone the criminal offence of insider dealing, which required prosecutors to prove beyond a reasonable doubt that the defendant knew or should have known that he was an insider and that he knew or should have known that he possessed inside information. Nevertheless, the FSA's tougher enforcement approach since 2007 and the new judgment-led regulation approach have had the effect of deterring market misconduct and led to a greater number of enforcement actions for market abuse and criminal prosecutions for insider dealing. The FSA asserts that its more aggressive enforcement posture has deterred significant amounts of market misconduct, especially with respect to insider dealing during takeovers. The FSA provides data to suggest that in 2009 unusual share price movements occurred before 30 per cent of UK-based mergers and acquisitions, which suggests the likelihood of leaked inside information before the official takeover announcement. By 2011, however, the figure had dropped to 20 per cent. This lower figure has been attributed to an increase in the number of publicized investigations, enforcement actions, convictions and penalties. Although it remains debatable whether the FSA's more proactive enforcement posture has actually deterred insider dealing and market abuse, it certainly marks an important move away from its previous 'light touch' enforcement approach that had resulted in pervasive market misconduct to a less cavalier, more compliance-based approach to market conduct.

In addition, the FSA's more proactive enforcement approach has benefited from greater resources that are derived from fees charged by the FSA to authorized firms and approved persons. In 2007, the FSA's budget for its enforcement division was £32 million; by 2012, this had increased to over £70 million. This has allowed the FSA to double the size of its enforcement division to approximately 400 staff, which includes lawyers, accountants, forensic experts, former police officers and intelligence officers. The enforcement division has been transferred to the new Financial Conduct Authority when the FCA takes up its powers in early 2013. Indeed, the FSA's acting head of enforcement has stated that despite its impending demise the FSA will be as active as ever in enforcing market abuse and insider dealing laws.[63] Moreover, the transfer of market abuse oversight and enforcement to the FCA in 2013 is part of a longer-term plan to maintain credible deterrence so that when the FCA takes up its new role it will continue with the judgement-led supervisory and enforcement approach that the FSA has already begun and which is mandated in the newly adopted Financial Services Bill 2012.

V. SUMMING UP

The regulation of insider dealing and market abuse has and will no doubt continue to raise a host of issues that would not ordinarily be encountered in the control of other anti-social conduct. The sophistication of financial markets, within which the law and

[63] See Martin Wheatley, Acting Director of the Financial Conduct Authority, Oral Evidence before the UK Parliament's Joint Committee on the Draft Financial Services Bill (24 October 2011) at 12.

regulatory mechanisms operate, compounds the practical and legal difficulties confronting those seeking to administer and apply the law. While the control of insider dealing and market abuse has much in common with the prevention and interdiction of money laundering and even corruption, the crafting of legislation and developing a supporting regulatory framework will involve issues of peculiar complexity and sensitivity. Despite these problems, the efficacy of anti-insider dealing and market abuse regulation has, in many countries, become almost a litmus test for the efficiency and competence of the wider regulatory structure overseeing the markets and the conduct of business in the financial sector.

In practical and political terms, the control of insider dealing and market abuse is a significant issue. While the various philosophical justifications for regulation may be argued about, it is the case that in many countries it is now recognized that the presence of such laws and regulation is required if investor confidence in the integrity of the markets is to be preserved and promoted. A somewhat cynical perspective might suggest that it matters little if the empirical evidence is equivocal as to the extent of the problem of insider dealing and market abuse and the harm it creates. If enough people think it occurs, for whatever reason, and consider it to be unfair, confidence in the reputation and therefore the efficiency of the market will be eroded. Consequently, those who are responsible for the protection of the markets have a responsibility to act. Whether this involves the use of the criminal law, or the civil law of market abuse, or some other regulatory mechanism, it is in the 'public good' that it be seen that insider dealing and market abuse are not condoned.

22. Insider trading in European law

Katja Langenbucher

The history of European insider trading law starts as late as 1966 with an expert report for the European Commission, advocating a new legal framework for "The development of a European Capital Market." Named after one of its authors, the "Segré Report" viewed insider trading as a "technical" problem, relating to directors or executives dealing in shares of their company.[1] Only in 1989 did the European Council pass a directive in order to coordinate the widely differing insider trading regimes in the Member States.[2] Fourteen years later, the European Parliament and the Council enacted a new directive addressing both insider trading and market manipulation as the two most prominent threats to smoothly working capital markets.[3] In 2011, the European Commission published proposals for both a directive and a regulation to update and expand its legal regime on insider trading and market manipulation.

US law has heavily influenced European insider trading law. This is particularly true with regard to legal concepts such as inside information, materiality and models of the reasonable investor's behavior. Surprisingly, however, European law deviates quite markedly from US law as far as policy issues are concerned. It references concepts that have long been dismissed in US law, such as the integrity of capital markets, and the necessity to place investors on an equal footing and to protect them from what is perceived as an injury resulting from the improper use of inside information. In contrast, the misappropriation theory endorsed by US courts, the Securities and Exchange Commission (SEC) and legal scholars alike[4] has not gained a strong foothold in European law.

[1] Report of a Group of Experts Appointed by the EEC Commission, The Development of a European Capital Market, at ch. 1 ¶ 8(iii) (November 1966).

[2] Council Directive 89/592/EEC of November 13, 1989 coordinating regulations on insider dealing, 1989 O.J. (L 334) 30 [hereinafter cited as 1989 Directive]. As an example highlighting the differing regimes consider Germany on the one hand (insider trading not addressed by any legal rule) and the UK on the other (first consolidated statutory regulation of insider trading by the Company Securities (Insider Dealing) Act 1985, which entered into force on July 1, 1985).

[3] Directive 2003/6/EC of the European Parliament and of the Council of January 28, 2003 on insider trading and market manipulation (market abuse), 2003 O.J. (L 96) 16 [hereinafter cited as MAD].

[4] See Chapter 1 of this book [Stephen M. Bainbridge, An Introduction to the *Research Handbook on Insider Trading*], at 8.

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Research Handbook on Insider Trading

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