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February 2019

# The Financial Conduct Authority – Part 2 – Criminal & Civil Insider Dealing

In a February 2019 speech, the FCA's Director of Market Oversight, Julia Hoggett, said the following:

> The life blood of all well-functioning markets is the timely dissemination of information, without which effective price information cannot take place. The malignant form of that same life blood is the misuse or inappropriate dissemination of that information.

The 'malignant form' to which Ms Hoggett referred is insider dealing, where someone trades on the basis of information not known to the public in order to make a gain or avoid a loss, or where one discloses such information and/or encourages others to trade in relation to it.

Insider dealing and market manipulation were both key parts of Ms Hoggett's speech, which is an important outline of what the FCA sees as the foremost issues for the firms it oversees. Ms Hoggett also referred to the FCA update to its 'Financial Crime Guide' for firms. A forthcoming GT Alert will address the updated guide and considerations for corporates flowing from insider dealing.

In this GT Advisory we focus on the definition of and defences to insider dealing in both the criminal and civil context, as well as the ways in which individuals in the UK have been pursued for such conduct.

## The Criminal Regime

Section 52 of the Criminal Justice Act 1993 (1993 Act) creates the specific criminal offence of insider dealing.

An individual who has **information as an insider** may face charges of insider dealing if he deals with price-affected securities in relation to the information. The acquisition or disposal in question must occur in a regulated market, or the person dealing must rely on a professional intermediary or is himself acting as a professional intermediary.

The encouragement of another person to deal in price-affected securities in relation to the information may also constitute insider dealing, as can mere disclosure of the inside information to another person other than in the proper performance of a person's employment, office or profession.

By virtue of Section 57 of the 1993 Act, a person has information as an insider if and only if:

1. It is, and he knows that it is, **inside information**, and
2. He has it, and knows that he has it, from an inside source.

A person has information from an inside source if and only if:

1. He has it through:
    a. Being a director, employee or shareholder of an issuer of securities; or
    b. Having access to the information by virtue of his employment, office or profession; or
2. The direct or indirect source of his information is a person who is one of the above.

Section 56 defines **inside information** as information which:

1. Relates to particular securities or to a particular issuer/s of securities and not to securities generally or to issuers of securities generally;
2. Is specific or precise;
3. Has not been made public; and
4. If made public would be likely to have a significant effect on the price of any securities.

The offence applies to all securities listed in the 1993 Act's schedule 2, which are shares, debt securities, warrants, depositary receipts, options, futures, and contracts for differences. An individual convicted of the offence is liable to a punishment of up to seven years imprisonment and/or a financial penalty and can expect to be pursued for any benefit accrued as a result of his criminal conduct under Part 7 of the Proceeds of Crime Act 2002.

Statutory Defences

The 1993 Act specifies that the following circumstances will not amount to insider dealing:

1. The individual shows that he did not at the time expect the dealing to result in a profit attributable to the fact that the information in question was price-sensitive information in relation to the securities.

2. The individual believed on reasonable grounds that the information had been disclosed widely enough to ensure that none of those taking part in the dealing would be prejudiced by not having the information.

3. The individual would have done what he did even if he had not had the information.

The above defences are also available to the individual accused of encouraging another person to deal in securities in relation to inside information. Those accused of disclosing inside information may be able to rely on the statutory defence that they did not at the time expect any person, because of the disclosure (made by the individual), to deal in securities in relation to the information.

### The Civil Regime

By comparison, the civil regime is contained within the Market Abuse Regulation (MAR). Article 14 specifically prohibits insider dealing and the unlawful disclosure of inside information. It states that a person shall not:

1. Engage or attempt to engage in insider dealing;

2. Recommend that another person engage in insider dealing to induce another person to engage in insider dealing; or

3. Unlawfully disclose inside information.

Insider dealing is defined in MAR Article 8 as having occurred when a person possesses inside information, the definition of which is broadly similar to that found in the 1993 Act, and uses that information by acquiring or disposing of (whether for himself or another) financial instruments to which that information relates. It also covers the cancelling or amending of orders concerning financial instruments to which the information relates, where the order was placed before the person concerned possessed the inside information.

Additionally, using recommendations or inducements given by someone who possesses inside information also amounts to insider dealing where the person using the recommendation or inducement knows or ought to know that it is based on inside information.

Article 10 explains that unlawful disclosure of inside information occurs where a person possesses inside information as defined above and discloses that information to any other person. It also includes the onward disclosure of recommendations.

### Legitimate Behaviour

MAR Article 9 describes situations which are considered to be legitimate and therefore not a breach of the prohibition on insider dealing, even if a person possesses and subsequently uses inside information.

These include:

1. Where a person conducts a transaction carried out in the discharge of an obligation that has become due in good faith and not to circumvent the prohibition against insider dealing, and (a) that obligation results from an order placed or an agreement concluded before the person possessed the information; or (b) that transaction is carried out to satisfy a legal or regulatory obligation that arose before the person concerned possessed inside information.

2. Where a person obtains the inside information in the conduct of a public takeover or merger with a company and uses that information solely for the purpose of proceeding with that transaction, provided that at the point of approval of the merger or acceptance of the offer by the shareholders of that company any inside information has been made public or has otherwise ceased to constitute inside information.

## Civil Enforcement

Section 123 of the Financial Services and Markets Act 2000 (FSMA), as amended, allows the FCA, acting as judge and jury, to impose a penalty on a person who it is satisfied has contravened the prohibition on insider dealing or unlawful disclosure of inside information. Alternatively, the FCA can choose to publish a public statement censuring the person.

Following an investigation, the FCA must first issue a warning notice to the person in question stating the amount of the proposed penalty and the terms of the proposed public statement. The FCA may also impose prohibitions and suspensions on individuals if it is satisfied that a contravention has occurred. If this is the case, the warning notice must state the proposed terms of the prohibition or the length of the proposed suspension.

Should the FCA decide to impose a penalty, prohibition or suspension, or to issue a public statement, a 'decision notice' must be issued informing the individual of the decision and explaining that the matter may be referred to the Tax and Chancery Chamber of the Upper Tribunal no later than 28 days after the notice is given. The Tribunal must consider what action, if any, it is appropriate for the FCA to take before remitting it back to them to give effect to the same.

In addition to the above, FSMA allows the FCA to apply to the High Court for an injunction restraining actual or likely contravention by an individual of MAR Article 14, ordering the individual to remedy the contravention, for example by requiring them to put in place systems or procedures to protect against a breach. It also may apply to the High Court for an order restraining any assets which the individual is likely to dispose of, or otherwise deal with; this ensures that funds are preserved to settle any future financial orders.

## Investigation, Prosecution & Enforcement

In contrast to spoofing, which we discussed in Part 1 of this series, the FCA has demonstrated it has a larger appetite for the prosecution of individuals for insider dealing.

Cases from recent years include Operation Tabernula, which concluded in May 2016 with the convictions of Martyn Dodgson and Andrew Hind for conspiracy to commit insider dealing. Mr Dodgson, a banker, was sentenced to four and a half years imprisonment and ordered to pay £1,074,236 to satisfy a confiscation order. Mr Hind, a property developer and accountant, was sentenced to three and a half years imprisonment and ordered to pay £624,521.

This case involved a total of eight individuals, three of whom were acquitted, as well as the use of unregistered or 'burner' mobile telephones, codes, encryptions, and safety deposit boxes.

During the investigation of this case the FCA searched a number of properties related to the individuals involved and uncovered a document from the pocket of a jacket found in the home address of Graham Shelley, who was convicted of insider dealing in March 2014 following a guilty plea. The notes on the document were recorded trades and the initials 'JR', a reference, so said the FCA, to trader Julian Rifat, who also pleaded guilty to insider dealing for passing inside information to Shelley. The FCA was able to cross-reference Shelley's trades with Rifat's activities and information he held as part of his employment.

Recent figures suggest that in the last five years, the FCA has prosecuted only nine insider dealing cases, securing twelve convictions.

The latest case involved former UBS compliance officer Fabiana Abdel-Malek and an associate named Walid Choucair. It was alleged that Ms Abdel-Malek used internal systems to access information about confidential deals and that these were passed on to Mr Choucair. The FCA alleged that meetings between the two at a nightclub in London's West End were for the purpose of exchanging tips and information, and that they also communicated through the use of 'burner' phones.

Having deliberated for 24 hours, the Southwark Crown Court jury indicated there was no reasonable prospect of reaching a verdict and therefore was discharged by Judge Joanna Korner. It has been confirmed that the FCA will pursue both defendants for a re-trial in April 2019. An analysis of civil enforcement, looking at fines imposed by the FCA since 2013, suggests they have only imposed three fines on individuals for civil breaches directly related to insider dealing.

## Much Ado About Nothing?

Ms Hoggett's speech suggests that insider dealing is very much on the FCA's radar; however, the numbers tell a different story. Most recent figures show that the FCA has less than 100 insider-dealing 'enforcement cases'.

These figures are surprisingly low when compared with a recent analysis of share price movements the day before every major profit warning and every merger and acquisition over the preceding two years. The analysis found that the day before a profit warning, the share price of the company involved fell in 67 percent of cases, and the price rose the day before a merger in 70 percent of cases.

Analyzing suspicious share price movements, however revealing about the arguable prevalence of insider dealing, highlights a further problem faced by the authorities in prosecuting such behaviour – like spoofing, you cannot prosecute by numbers alone.

Insider dealing cases typically will involve arguments about whether or not the 'information' was in fact 'inside information' as defined by the 1993 Act, sparking questions about how specific/precise the information is and if it was in fact in the public domain. Additionally, prosecutions of those alleged to have received information, for example from an employee of the issuer in question, may accept their association with the employee as alleged but argue that it was an innocent one and that there were other, unrelated reasons why they conducted the trade which allowed them to make significant gains or avoid a loss. Others may argue they did not know that the information was inside information. It can be hard for prosecutors to prove the alleged nefarious nature of the relationship despite apparent 'red-flags'.

It was possible in Tabernula with the strong evidence yielded from the investigation. In the absence of strong evidence, with cases that are almost by definition inferential it is far from straightforward for the FCA to convert statistics into convictions.

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