

## Insider Trading

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27 Nov 2014 Azizur Rahman.

### Greed is Good

**“Someone remind me I once said, ‘Greed is good’. Now it seems it’s legal.” Gordon Gekko (Michael Douglas) in ‘Wall Street: Money Never Sleeps’. There has long been a perception that the Gordon Gekko types have been getting away with it for years. The Financial Conduct Authority (FCA), replaced the old Financial Services Authority (FSA) and appear to be getting tougher on prosecuting these sorts of cases.**

### What is the Law on Insider Trading?

The modern law on insider trading is found in Part V of the Criminal Justice Act 1993.

Section 52 of the Act provides that it is an offence for “an insider” to deal in “price-affected securities”. An ‘insider’ is an individual who has ‘information’ as an insider. The information must relate to particular securities (eg stocks and shares) or issuer of securities and be “specific or precise” and which has not been made public. The person gains inside ‘information as an ‘insider’ by virtue of his position in the company, director employee etc or by reason of some other employment or profession, eg an independent accountant advising the company.

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## Defences to Insider Trading Allegations

The defences are set out in s53 and include that the defendant “did not expect the dealings to result in a profit” or had reasonable grounds to believe “that the information had been disclosed” or that he would have “done what he did even if he had not had the information.”

In addition there are four specified ‘special defences’ set out in Schedule 1 of the Act. Broadly speaking these are designed to ensure that the offences set in s52 do not affect practices which have always been regarded as legitimate, e.g. having ‘inside information’ which is also just “market information”. Market information basically relates to information pertaining to the acquisition or disposal of particular securities and/or the fact that such transactions are under consideration or negotiation. Account is to be taken of whether the person was acting reasonably “despite having that information as an insider at the time” – these ‘special defences’ are simply broad and general allowing traders or buyers to plead that they were doing no more than using information properly and reasonably and not mis-using inside information.

## FCA Investigations of Insider Trading

Prosecutions under the 1993 Act usually require the consent of the Secretary of State or the Director of Public Prosecutions; unless the SFO is involved as the case involves serious or complex fraud. The FCA’s primary role is to regulate – prosecution is an option but should be the last option.

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The Financial Services & Markets Act 2000 ("FSMA") is the starting point for all FCA matters. The FSMA sets out, at section 188, seven types of behaviour which it regards as 'market abuse'; this un-surprisingly includes insider dealing. However, a 'market abuse' matter may be regarded as a civil or a criminal matter (see s123) and representations can be made by suspects to try and push the FCA into the civil/regulatory route, rather than the criminal route, if appropriate. We have seen recently the FCA fining Barclays and RBS banks for misconduct in connection with LIBOR and EURIBOR submissions whilst the SFO are prosecuting individuals. Further, the Serious Organised Crime and Policing Act 2005 provides powers, in some circumstances, for prosecutors (including the FCA and the SFO) to enter into immunity deals with suspects and be able to offer reduced sentences in return for co-operation. Once into this territory of course some delicate handling and very careful consideration is required.

The FCA has its own systems for monitoring movements within the markets. For example, the FCA's figures showed that in the year end 2008, 53 out of 181 takeover transactions indicated an 'abnormal pre-announcement price movements' – i.e. just under 30% of the 181 transactions studied were announced to the world shortly after a sudden increase in the price of the company shares (see Compliance Officer Bulletin, Market Abuse, 2010).

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But having a chat with a mate down the pub and getting him to buy shares that are about to increase in value is always going to be difficult to detect. That said the more trusted associates/family members that are involved the greater the risk of compromise. The reality is that often the situation is much more subtle with, for example, senior brokers who is legitimately in receipt of price sensitive confidential information in relation to, for example, an upcoming deal between two listed companies that will affect share prices. How that dealer deals with his junior brokers, how the shares are advertised, how other brokers deal with the same shares will all come into play in assessing whether the broker's behaviour amounts to proper legitimate trading activity, abusive insider dealing or whether the 'special defences' in Schedule 1 of the Act applies (see above).

Prosecutors would point to increased ingenuity on the part of those trading with inside knowledge. For example the use of so-called Exchange Traded Funds ("ETFs"). ETFs are basically funds which comprise of a bundle of securities including shares. ETFs will be bought and sold in the same way as simple shares – unlike most conventional investment funds. Thus someone with inside information about company X can buy into an ETF that includes shares in company X and then short sell the other products – perhaps for a small loss. The effect is to hide the purchase of the shares because it is not purchased directly.

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## The Future for Insider Trading Investigations

The FCA is in reality a revitalised FSA and has an increased appetite for prosecutions as does the SFO. Generally, since the LIBOR scandal and now FOREX investigations there is more of a willingness to prosecute the big institutional cases. Where that happens small cases too tend to get prosecuted rather than dealt with through a civil route. There will undoubtedly be an increase in co-operation both between UK organisations such as City of London Police and the FCA, but more importantly perhaps between the UK and foreign enforcement authorities. We predict that all these factors and the increase generally in the use of plea negotiation, as well as immunity from prosecution etc under SOCPA, all suggest that insider trading will become a much more common-place prosecution and that suspects on the receiving end will need to take early specialist advice.

You can read more about FCA Investigations here.

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**Conspiracies/Serious crime.** Rahman Ravelli are members of the Specialist Fraud Panel and have been ranked by Legal 500 as an 'exceptional' firm with Aziz Rahman being described as 'top class'. The firm is also ranked in Chambers & Partners. Rahman Ravelli are a Top Tier and Band 1 firm.

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