The Global Squeeze On Insider Trading

Law360, New York (January 3, 2011) -- The recent global financial crisis has led to an increased emphasis on cross-border regulatory enforcement. As regulators across the globe strive to keep pace with the multinational entities they regulate, they are increasingly seeking the assistance of their regulatory counterparts overseas.

These cross-border efforts are buoyed by initiatives such as the International Organization of Securities Commissions information-sharing agreement, into which more than half the world’s securities regulators have entered, and various bilateral and multilateral treaties among government agencies.

Through information exchange and other forms of cross-border enforcement assistance, these cross-border relationships and initiatives have allowed regulators to conduct investigations into market abuse with an unprecedented aggression and ever-expanding scope.

Global Crackdown on Insider Dealing

Insider dealing enforcement, in particular, has gained a renewed emphasis in the global marketplace, with Asian, American and European regulators each undertaking their own initiatives aimed at cracking down on insider dealing.

The U.S. Securities and Exchange Commission and the U.K. Financial Services Authority, for example, have initiated reforms this year that adopt an increasingly aggressive posture against perceived instances of insider dealing. The SEC has introduced specialized investigative units that focus on large-scale and organized insider dealing and market manipulation schemes, and the FSA has committed itself to pursuing criminal prosecutions for insider dealing.

Similarly, in Hong Kong, although it was not until 2008 that the Securities and Futures Commission (SFC) brought its first criminal prosecution for insider dealing, the SFC obtained the convictions of five individuals, one of whom was a banker who passed inside information to his girlfriend and family regarding a deal on which he was advising, and since then has intensified its criminal prosecution of insider dealing.

Increased Activism of the FSA

The FSA has had the power to institute criminal proceedings for insider dealing since December 2001 under Part V of the Criminal Justice Act 1993 and Section 402 of the Financial Services and Markets Act 2000 (FSMA). It first exercised its power in January 2008 when it commenced proceedings against Christopher McQuoid and James Melbourne for insider dealing.

McQuoid, a solicitor at TTP Communications, was charged with passing inside information in relation to a takeover of TTP by Motorola to his father-in-law, Melbourne, who then traded on that information. Both men were convicted in March 2009. Since then, the FSA has embarked on a series of high-profile prosecutions for insider dealing.

In November 2009, Matthew Uberoi and his father were found guilty of 12 counts of insider dealing for trading on information obtained by Matthew Uberoi while he was an intern at a firm dealing with takeovers and price-sensitive deals.
Malcolm Calvert, a former partner and trader at the firm Cazenove, was found guilty in March 2010 of five counts of insider dealing on a trio of corporate deals for buying shares in companies just before takeovers were unveiled.

In November 2010, Neil Rollins, a former senior manager of PM Onboard Ltd., was found guilty of five counts of insider dealing and four counts of money laundering after he traded on information he obtained by virtue of his senior position at the company, encouraged his wife to do the same, and laundered the proceeds when he became aware of the FSA’s interest in his dealing.

On March 15, 2010, Christian Littlewood, a senior investment banker who had previously worked for Dresdner Kleinwort and British brokerage firm Shore Capital, and his wife were charged with 13 counts of insider dealing for offenses relating to trading in various London Stock Exchange and AIM-listed shares. A third suspect, Helmy Omar Sa’aid, was arrested in the French overseas territory of Mayotte, and for the first time, the FSA sought the extradition of a suspect to face criminal charges in the U.K. Following the successful extradition of Mr. Sa’aid, the FSA charged him with 13 counts of insider dealing and one count of conspiracy to commit insider dealing.

In another high-profile case, on March 23, 2010, seven men were arrested after the U.K.’s biggest swoop on an alleged insider dealing ring to date in the first operation carried out jointly between the FSA and the Serious Organised Crime Agency. A squad of 143 officers raided 16 residential and business addresses in London and southeast England, seizing documents and computers.

The recent spate of insider dealing prosecutions confirms the FSA’s broader mission to use its enforcement powers as a means to achieve “credible deterrence.” The FSA’s position is that credible deterrence is best achieved by the prospect of imprisonment and by criminal cases, which generate more publicity. Indeed, in the last several years the FSA has increased the resources it needs to deliver this particular form of credible deterrence and it now has a team of specialist prosecutors with powers to bring criminal proceedings and has increased the staff of its enforcement division from 250 to 400.

Trans-Atlantic Cooperation

One of the FSA’s key priorities for the upcoming year is working with international partners to combat financial crime. In 2009, the FSA’s enforcement division investigated 30 overseas businesses, a six-fold jump over the five it investigated in 2008. The FSA also significantly increased its level of assistance to foreign regulators, receiving 830 new requests for assistance in the 2008-2009 fiscal year, up by 27 percent from 2007-2008.

In February 2010, the respective heads of the FSA and SEC met for what has become an annual meeting to discuss the expanding levels of cooperation between the two agencies. That same month, the U.K. Court of Appeal upheld the FSA’s broad statutory authority to assist the SEC, holding that nothing in the FSMA required the FSA to satisfy itself of the correctness of information it was being asked to investigate or disclose and that the FSA could seek documents it reasonably considers relevant to an investigation by the SEC.

Recent events indicate that the FSA increasingly will seek assistance from U.S. authorities in its enforcement actions. In May 2010 the FSA contacted more than 38,000 people across the U.K. to warn them that they were targets of “boiler room” fraud after recovering a list of names and addresses used by “fraudsters” who cold called people to offer worthless shares. The FSA recovered the list through collaboration with U.S. authorities, namely the Immigration and Customs Enforcement and the Internal Revenue Service.

On Nov. 25, 2010, the FSA also charged five people, including two former directors and one former senior trader of brokerage firm Blue Index Ltd., with 17 counts of insider dealing. Several of the charges related to U.S. technology deals.

The FSA announced that it worked in parallel with U.S. authorities, namely the SEC, the FBI and the U.S. Department of Justice, and that “[t]he action on both sides of the Atlantic demonstrates the way in which close cooperation between regulators is tightening the net on people who set out to abuse markets, wherever those people or markets are based.”

Days later, the SEC charged a former Deloitte Tax LLP partner and his wife in connection with the Blue Index investigation.
for repeatedly leaking confidential merger and acquisition information to family members in the U.K. in a multimillion dollar insider dealing scheme.

The SEC similarly has relied on trans-Atlantic cooperation in its enforcement actions. In 2008, for example, the SEC received assistance from the FSA in its action against Taher Suterwalla, a U.K. resident, for insider dealing charges relating to purchases of call options from a Swiss financial institution, which filled his orders by purchasing Petco Animal Supplies Inc. call options in the U.S., in the three weeks preceding Petco’s acquisition announcement.

In a separate case, a U.S. federal court in 2009 entered a $2.35 million judgment against a U.K. citizen, Glenn Manterfield, in an SEC enforcement action alleging that Manterfield engaged in a scheme to defraud over 60 hedge fund investors. The SEC received assistance from both the FSA and English courts, making an application with the High Court to freeze Manterfield’s U.K. assets, which the High Court granted. The FSA also has been providing assistance to the SEC in its investigation into Bernie Madoff, specifically at the identity and conduct of certain U.K.-based feeder funds which placed investor money with Madoff’s Bernard L. Madoff Investment Securities LLC.

The increasing cooperation between the SEC and the FSA reflects the wider cooperation that is taking place across the Atlantic between U.S. and U.K. enforcement agencies with regard to financial crime in general and the overall trend towards parallel proceedings.

In February 2010, one of Europe’s largest defence contractors, BAE Systems PLC, agreed to pay over $400 million to settle corruption charges with both the U.K. Serious Fraud Office (SFO) and the U.S. DOJ, which was the first investigation in which the SFO and DOJ collaborated with each other.

The DOJ also recently worked with the City of London Police in a Foreign Corrupt Practices Act investigation and undercover “sting” operation which resulted in the arrests of 22 executives from 16 different companies based in the U.S., U.K. and Israel and involved 150 FBI agents and the execution of 14 search warrants in the U.S. and seven search warrants in the U.K.

Best Practices Guidance for Corporate Clients

The increase in insider dealing enforcement and global cooperation among financial regulators means that the number of cross-border insider dealing prosecutions likely will continue to rise. The FSA in particular shows signs of increasingly relying on trans-Atlantic assistance and its prosecutorial powers to enforce insider dealing violations.

Companies should implement effective global compliance measures and ensure that their risk management strategy incorporates specific policies and procedures on insider dealing with a view to avoiding governmental investigations, which often lead to reputational damage and involve significant costs and time. In this regard, we provide the following tips on best practices for minimizing risks of insider dealing:

- Maintain ongoing training on insider dealing for all employees, including low-level employees, and provide insider dealing policies not only to employees but also to agents and consultants.
- If you are a listed company, as a general rule, you should assess the extent to which inside information is accessible within the company and minimize that access. If the FSA, for example, requests a list of persons with access to inside information and the list is long, the FSA may question whether you have complied with your obligation to limit access to inside information.
- If you are a listed company, routinely monitor insiders to ensure that they comply with their reporting duties and that they do not trade during "black-out periods" before financial results become public. It is good practice for private companies also to have “black-out periods” to prohibit trading in shares of companies involved in projects on which employees are working. For those employees who are not subject to “black-out” periods, consider whether these employees should obtain pre-clearance prior to trades or exercises of stock options.
- Auditing employees with access to inside information is an effective deterrent. If you rely on audits, publicize the fact that employees are subject to audits and target employees who are exposed routinely to confidential, inside information. Maintain an audit trail of which employees accessed inside information and when.
For buy-side investors, be wary of receiving “tidbits” of nonpublic information, which when viewed in isolation are nonmaterial but taken together can amount to material information and can give rise to an insider dealing violation. Also consider whether the source of your information is breaching a duty by providing it to you.

Encourage management to implement cultural change. Although most institutions have a set of “core values,” there often is a gap between these ideals and what in reality is practiced. Structure a process of reviewing your firm’s culture to ensure that it deters poor behavior and incentivizes good behavior by requiring high standards of effective risk-management, routinely assessing the integrity of management, and providing appropriate training.

Market abuse and insider dealing investigations raise a number of complex issues for companies. If you or your employees are the subject of governmental investigations or proceedings, specialist legal advice should be sought. It is important to bear in mind that an insider dealing investigation initiated in one country may have ramifications in another, even where the other country’s regulators are not involved in the underlying investigation. For example, in September of this year, the FSA fined Goldman Sachs International £17.5 million related to its failure to notify the FSA that Fabrice Tourre had received a Wells Notice in connection with the SEC’s investigation into the Abacus 2007-AC1 synthetic collateralized debt obligation.

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