

CLIFFORD
CHANCE



MARKET ABUSE CHALLENGES AND TRENDS
TECC 2022

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GENERAL ENFORCEMENT TRENDS

Lock-down effect

- Covid-19 and lockdown had a significant effect on FCA enforcement activity.
- The opening of new investigations slowed markedly (125 in 20/21 vs 184 in 19/20).
- The progress made in existing investigations also slowed and many were, at least initially, hampered by the need to conduct them remotely, including remote interviews.
- Our general experience, which reflects the last few years, is that some investigations progressed timeously, but others progress very slowly (76 of the FCA's current cases have been open for over two years).
- The average length of an investigation has 'speeded up', partly driven by the fact that 186 cases were closed in 20/21, but still takes more than two years, assuming the investigation is discontinued or settled.
- There has been a downturn in the number of financial penalties imposed in the last two years (21 in 2019, 11 in 2020, 10 in 2021 and 8 so far in 2022).
- There has been a heavy focus over the last year on financial crime systems and controls cases.
- As at end of March 2022, FCA had 71 open insider dealing investigations (12% of its caseload).
- The number of enforcement staff has reduced from 699 to 625 (11% reduction).

GENERAL ENFORCEMENT TRENDS

Expectations going forward

- The number of new investigations is increasing (194 opened in 21/22), although many relate to policing the perimeter.
- The FCA has also signaled a more interventionist approach to regulation (and enforcement). We expect the FCA to take swifter and more decisive action where concerns are raised, particularly those that impact on customers.
- This approach extends particularly to regulatory intervention (imposition of requirements and restrictions):
 - FCA has reduced oversight by the RDC of FCA decision-making, effectively limiting it to enforcement decisions.
 - FCA is likely to bring more 'difficult' or less clear-cut cases. The FCA board has said that it supports "*proposals to recalibrate the degree of legal risk the organisation is willing to take*". The board's view is that a "*willingness to 'take legal risk, especially in situations where the law is unclear or FCA action is intended to prevent imminent consumer harm, was entirely appropriate.*"
- Have still only seen one concluded senior manager enforcement case:
 - "*The Senior Managers and Certification Regime is a cogent framework for injecting sharper focus on conduct risk into the fabric of an organisation. The rules here do not exist as externalities, they are under the skin of the firm.*" Mark Steward, Executive Director of Enforcement and Market Oversight

CRIMINAL PROSECUTIONS

Criminal prosecutions are an ingrained feature of tackling market abuse

- CFO of Redcentric Plc was convicted of two counts of making a false or misleading statement, contrary to section 89(1) of the Financial Services Act 2012, and 3 counts of false accounting, contrary to section 17(1)(a) of the Theft Act 1968. Followed a former finance director pleading guilty.
- Mohammed Zina and Suhail Zina: Trial is due to start in October 2022 of two brothers accused of 6 offences of insider dealing and 3 offences of fraud by false representation.
- FCA has a further three cases in which prosecution decisions will be made relating to 10 individuals before the end of the year.

Prosecution difficulties

- Prosecution (with conviction) sends a powerful message.
- However, it is not without its difficulties:
 - Prosecutions are extremely resource intensive and the higher burden of proof and involvement of a jury can lead to acquittals/hung juries
 - CEO of Redcentric was acquitted.
 - Banca Monte dei Paschi di Siena prosecutions overturned.
 - Stuart Bayes/Jonathan Swann – charged in early 2021 on charges of insider dealing relating to trading in British Polythene Industries shares, jury could not reach a verdict during trial in the summer and will be retried in September 2023.

MISUSE OF INSIDE INFORMATION - UNLAWFUL DISCLOSURE

Sir Christopher Gent

- £80,000 FCA fine of Sir Christopher Gent, former non-executive Chairman of ConvaTec Group Plc, for unlawfully disclosing inside information to two major shareholders.
 - Information was precise, notwithstanding the company needed to finalise its financial forecast review and the board needed to sign it off and the CEO had not confirmed he would be retiring.
 - An issuer has a short period of time *“to make preparations for the announcement to be made and to avoid disclosing information which would lead to the public making incorrect or incomplete assessments of the information disclosed.”*
 - Reinforced the need for a legitimate reason for selective disclosure of inside information.

A v AMF

- Daily Mail journalist published articles relating to a possible takeover bid for two Euronext listed securities. Before doing so, Mr A disclosed the information to two individuals who traded.
- ECJ confirmed that a rumour about a takeover could be precise information.
- Journalist and media outlet's reputations are relevant to this conclusion.
- Journalists subject to the lawful selective disclosure requirements.

MISUSE OF INSIDE INFORMATION - SYSTEMS AND CONTROLS

MIO Partners Inc

- \$18 million fine by the SEC for compliance failures in handling nonpublic information.
- MIO Partners Inc. invested on behalf of current and former McKinsey partners and employees.
- Certain McKinsey & Co. partners oversaw MIO's investment decisions as members of the Investments Committee of MIO and also had access to MNPI as a result of their work advising clients of McKinsey (including, for example, financial results, planned bankruptcy filings, mergers and acquisitions, product pipelines and funding efforts, and material changes in senior management).
- Certain investments were made in securities in respect of which certain Investments Committee members had access to MNPI.
- The SEC's investigation found that MIO Partners Inc. maintained inadequate policies and procedures to prevent McKinsey partners from misusing the MNPI when overseeing MIO Partners' investment decisions. MIO's written policies and procedures were silent about the fact that McKinsey personnel on the Investments Committee had access to MNPI and did not contain a recusal procedure reasonably designed to guard against the misuse of MNPI.
- There was no finding that MNPI had been misused.

MISUSE OF INFORMATION - SHADOW TRADING

SEC v Panuat

- In January 2022, a federal district court in California declined to dismiss the SEC's first "shadow trading" enforcement case.
- Court considered that case was appropriate in that it was based on the existing "misappropriation theory" of insider trading: materiality, breach of duty and scienter.

Implications for UK/EU institutions

- MAR captures shadow trading. Inside information includes information that *"relates, directly or indirectly, to one or more issuers or to one or more financial instruments"*.
- Main issue is whether the information about security A is price sensitive about security B.
- Takeaway from some US commentators of *"don't make your policy broader than it needs to be, because you could criminalise trading that would not otherwise be criminal"*, does not work under MAR.
- Can you put in place surveillance systems that cover other potentially affected stocks?
- What are the implications for wall crossing?

MARKET MANIPULATION – FALSE AND MISLEADING INFO

Carillion

- Carillion was censured by the FCA for breaches of Article 15 of MAR (prohibition of market manipulation), Listing Rule 1.3.3R (misleading information must not be published), Listing Principle 1 (procedures, systems and controls) and Premium Listing Principle 2 (acting with integrity).
- But for Carillion’s financial circumstances, a penalty of £37.9 million would have been imposed.
- Carillion had made a series of positive (misleading and reckless) announcements during 2016 and 2017, which did not reference an expected provision of £845 million announced in July 2017.
- Over time, Carillion’s actual financial performance and its performance as budgeted and ultimately reported to the market diverged. The gap was bridged by overly aggressive contract accounting judgements to maintain reported revenues.
- FCA has decided to fine CEO and two CFOs. They have referred their cases to the Upper Tribunal.
- Some of the issues that Tribunal will consider include the meaning of a director being “knowingly concerned” in a breach of their firm’s obligations.