



A PRACTITIONER'S GUIDE TO **THE LAW AND REGULATION OF MARKET ABUSE**

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A Practitioner's Guide to the Law and Regulation of Market Abuse

Biographies

Martyn Hopper specialises in financial services regulatory work including advising on compliance issues, regulatory investigations, enforcement actions and related litigation. Martyn spent over nine years at the Financial Services Authority, latterly as a Head of Department within the Enforcement Division and was heavily involved in work on the design and implementation of the Financial Services and Markets Act 2000, including the market abuse regime.

Christine Astaniou is a professional support lawyer in the financial services practice at Herbert Smith Freehills, focussing on the analysis of contentious aspects of law and regulation in the financial services industry, in particular market abuse and the retail distribution of investment products. Christine spent three years in Herbert Smith Freehills' Hong Kong office and is also a contributing author to Competition Law in China and Hong Kong (Sweet & Maxwell) and Hong Kong Civil Procedure – The Hong Kong White Book (Sweet & Maxwell).

Karen Anderson is a partner in the financial services regulatory practice of Herbert Smith Freehills, who focuses on providing technical advice on regulatory issues and analysing new law and regulation. Through her participation in the City Liaison Enforcement Group and more recently through the City of London Law Society Regulatory Committee, the BBA Market Abuse working group and the Law Society Banking Reform working group, Karen has been actively involved in discussions with the UK Treasury and regulator regarding the legislation and regulation of financial services.

Nikunj Kiri advises a wide range of firms on regulatory and compliance matters, including conducting internal reviews,

assisting clients in managing skilled persons' reviews and in managing communications with regulators, and representing clients in regulatory investigations and enforcement proceedings. Clients regularly seek Nik's advice on compliance risk management issues, including on the practical application of the rules on market abuse, conflicts of interest, the conduct of business and client money.

Tim West is a partner in the corporate division of Herbert Smith Freehills who specialises in investment funds and asset management, and has been involved in establishing, restructuring and providing ongoing advice to a wide range of public and private funds covering a broad range of asset classes. Tim also advises pension funds, insurance companies and sovereign wealth funds, and on investment management arrangements with third party managers. He also works with lending banks providing facilities to private equity funds and acts for underwriters to investment fund fundraisings. Tim is noted for his contributions to the hedge fund industry – he advised the Hedge Fund Working Group on the preparation of its report into industry best practice and continues to advise its successor, the Hedge Fund Standards Board. He was listed in *Financial News*' "40 Under 40 Rising Stars of Hedge Funds 2011".

Carol Shutkever is a partner in the corporate division of Herbert Smith Freehills who concentrates on providing technical advice on corporate law and listed company regulation, with a particular focus on corporate governance issues. Her role includes analysing new law and regulation and ensuring that the firm is at the forefront of corporate law and practice. Carol has a broad experience in corporate and commercial transactions, equity fundraisings, M&A and financial services regulation. She is a member of several UK Law Society company law working parties, a member of the Advisory Board for Gore-Browne on Companies and a contributor to Buckley on the Companies Act.

Mark Bardell is a partner in the corporate division of Herbert Smith Freehills whose practice encompasses a wide variety of

domestic and cross-border, corporate finance and merger and acquisition work, including public takeovers, private M&A, joint ventures and capital markets. In September 2011, he completed a two year secondment as Secretary to the UK's Takeover Panel. During that time he was closely involved in regulating takeovers of UK public companies and in revising the UK's Takeover Code, in particular the significant changes to the UK's Takeover Code, which came into effect in September 2011.

Craig Cordle is an associate in the corporate division of Herbert Smith Freehills, specialising in investment funds matters. He advises on all aspects of the structuring, establishment and operation of investment funds and other collective investment arrangements. Craig has extensive experience of listing investment funds on the UK Listing Authority Official List and the Specialist Fund Market, as well as other exchanges. He also acts as ongoing legal counsel to various boards of investment funds and has experience of marketing investment vehicles in various onshore and offshore jurisdictions.

Antonia Kirkby is a professional support lawyer in the Corporate Division at Herbert Smith Freehills. She specialises in giving technical advice on company law and listed company regulation. From 2003 to 2006, she was secretary to the City of London Law Society Company Law Sub-Committee and continues to work as secretary to the Joint Takeovers Working Party of the City of London Law Society Company Law Sub-Committee and The Law Society of England and Wales' Standing Committee on Company Law.

Sophia Reeves is a senior associate in financial services regulatory practice at Herbert Smith Freehills, specialising in advising on regulatory issues under the Financial Services and Markets Act 2000, including market conduct matters. Sophia advised on a review of the market abuse risks associated with algorithmic trading strategies for a major investment manager, undertaken in response to an FSA supervisory request.

Preface

Market abuse remains a significant threat to the reputation of UK financial markets and to the credibility of the regulatory system. When the Financial Services and Markets Act 2000 came into force, the Financial Services Authority (FSA) assumed central responsibility for dealing with market abuse. Ever since then, the regulator's ability to successfully prosecute market abuse cases (whether through the criminal justice system, the civil courts or the administrative/disciplinary process) and so to demonstrate that it is deterring market misconduct, has been a key strategic priority. The media and the financial markets also view this as a key test of the regulator's effectiveness. There seems little doubt that the Financial Conduct Authority (FCA), which began operating on April 1, 2013, will be judged by the same standards.

Recent developments demonstrate the regulator's determination to meet this challenge using the full panoply of legal powers at its disposal: since 2001 the FSA successfully concluded a plethora of market abuse enforcement actions resulting in 76 final notices; it also used its disciplinary powers against FSA-regulated firms or individuals to punish market misconduct in a number of cases; it made use of its civil powers to obtain injunctions to restrain market abuse; and it secured 22 convictions and numerous prison sentences through the criminal courts. Experience now tells us that the FCA will be prepared to make full use of its power to conduct criminal investigations and pursue criminal prosecutions. "Dawn raids" conducted by the regulator in conjunction with the police illustrate that individuals caught up in market abuse investigations are at real risk of arrest in their homes in the early hours of the morning.

At the same time the FSA placed increased pressure on financial institutions and on listed issuers to examine and improve their own internal policies, procedures, systems and controls with the aim of preventing or detecting market abuse.

Again, these trends look set to continue under the new FCA regime.

As a result, it is now more important than ever that market professionals are properly versed in what does and does not amount to market misconduct and in the practical steps that should be taken in order to avoid them or their firms coming under suspicion. However, this presents a major challenge.

The legal and regulatory rules governing market misconduct in the UK are now extremely complex and open to many arguments over interpretation. Perhaps surprisingly for an offence that carries with it such moral opprobrium in the eyes of the public and the market, there are few black and white lines, and much scope for debate as to what does or does not constitute market abuse. The overlapping criminal, civil and administrative regimes, each with different definitions of market misconduct render the provisions intimidating to many lawyers. The complexity has only been aggravated by the way in which the UK Government and the FSA chose to implement the European Market Abuse Directive. Further complications are also likely to be on the horizon as a result of the European Commission's review of the Directive.

The challenge then, to which lawyers and compliance officers must rise, is to translate these complex provisions in a way that provides practical, workable and reliable guidance for those working in the financial markets. If the market abuse regime is to be effective it cannot become regarded as a legalistic maze that is the preserve of regulators, lawyers and compliance professionals. Market professionals need to be equipped to make or at least to spot the judgement calls to which the market abuse regime gives rise in innovative, fast-moving, global financial markets.

It is hoped that this book will do something to assist in meeting this challenge.

Herbert Smith Freehills LLP

April 2013

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Chapter 1

Overview of market conduct regulation in the UK

Martyn Hopper

1.1 What is market abuse?

Broadly, when we talk about “market abuse” in the context of financial markets, we are usually referring to one of two types of misconduct:

1. Insider trading: where someone obtains privileged access to market-sensitive information ahead of others and seeks to exploit that information advantage for his own benefit before the rest of the market becomes aware of that information.
2. Market manipulation: where market prices and/or trading volumes are distorted either by someone misleading others in the market through their statements or conduct or by someone unfairly exploiting their ability to move market prices to their own advantage.

These are not the legal definitions, but they help to communicate the broad scope of what we are discussing here.

Generally, these types of misconduct are of concern in organised financial markets where buyers and sellers come together to trade on an anonymous basis – such as on an investment exchange. Indeed, in most other markets, prices are set by the forces of supply and demand, and buyers and sellers are free to exploit whatever information they can lawfully obtain. To use an obvious example, one would not object to a prospective purchaser of a house making use of relevant,