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Abstract

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On the effectiveness of insider dealing regulations

Insider dealing can undermine the integrity of the financial system by vitiating the normal efficiency of financial markets and corroding investors' confidence. Insider dealing is a threat and should be minimised to keep UK capital markets clean and attractive for sustainable growth. This thesis will aim to examine the effectiveness of insider dealing regulations in the UK by investigating into the challenges to enforcement and will present a novel form of evaluation of the deterrent effect of civil financial sanctions.

This inter-disciplinary thesis will approach this task by regarding some challenges to enforcement of insider dealing regulations as ineradicable, i.e., those challenges being associated with the nature of insider dealing, and some challenges will be deemed to be rectifiable, such as a properly devised deterrence-based enforcement strategy. The two sets of challenges will be reduced to a quantification issue, that is, the Financial Conduct Authority cannot, at least constantly, precisely quantify the illegal gains from insider dealing and the ambiguous nature of disgorgement, as a financial penalty component. On the basis of these considerations, the thesis will put forward a theoretical two-step metric for evaluating a deterrent effect in civil financial sanctions. This metric is original in a number of ways, (1) it will subsume the discussed challenges and treat them as the underlying assumptions and (2) it will infer a deterrent effect from the observed enforced civil cases. The results obtained from the two-step metric indicate that in around half of the selected civil cases the financial sanctions were lower than the quantified illegal gains. Therefore, insider dealing regulations in the UK are not effective. The thesis will also examine whether the level of quantified ill-gotten gains from insider dealing standing alone has influenced the magnitude of a civil financial sanction. By applying a one-way ANOVA test, it will be observed no statistically significant relationship between the aforementioned impact factor and the three penalty groups.

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I own everything to my mom and dad, there are no words exist to express my love and appreciation for everything my parents have done for me. I only hope that I am able to make them proud. Thanks to my brother and his family, my grandparents, and my sweetheart for supporting me during this journey.

Declaration

I declare that this thesis has been composed solely by myself and that the work contained herein is my own except where explicitly stated otherwise by reference or acknowledgement. This work has not been submitted for any other degree, in whole or in part, in any previous application for a degree.

CHAPTER ONE

The Introduction to the Research

Section 1.1. will provide a background to the research, establish the purpose and set out the central argument of the research, and engage with the relevant literature to identify a lacuna in the existing knowledge which this thesis will attempt to fill. Section 1.2. will posit two overarching questions. Each of these questions will be answered through a series of sub-questions. Section 1.3. will introduce this PhD's methodology(s) in relation to each chapter. Section 1.4. will delineate the focus and main arguments of the research. In section 1.5., the key findings and contributions to the existing knowledge will be provided together with several considerations with respect to regulatory implications. Due to the ongoing overhaul of the financial services regulatory system in the UK, section 1.6. will point out how this upcoming restructuring can affect the research's findings.

1.1. The fundamentals of the research

The background to the research

Insider dealing is a criminal offence under Part V of the Criminal Justice Act 1993 and a civil offence under the Market Abuse (Amendment) (EU Exit) Regulation 2019 No. 310. Both the regimes provide for three types of insider dealing offences, namely, dealing, improper disclosure and encouraging a third person to deal in non-public price sensitive inside information on a regulated market. The criminalisation of insider dealing in the UK in 1980, and then the introduction of the civil regime in 2000, as it will be shown in chapter three, were predicated on the assumptions of deterrence theory according to which it was expected that certain and severe punishment would make would-be offenders refrain from violating the law.[1] Enforcement of insider dealing regulations is carried out by the the Financial Conduct

[1] See chapters three and six

Authority (hereinafter the FCA), a non-governmental company limited by guarantee and accountable to HM Treasury.[2]

Section 1D of the Financial Services and Markets Act (hereinafter the FSMA 2000) sets down the integrity objective which the FCA must protect and maintain. This objective is defined as, (a) the soundness, stability and resilience of the UK financial system, (b) the UK financial system is not being used for a purpose connected with financial crime, (c) the UK financial system is not being affected by insider dealing and market manipulation, (d) the orderly operation of the financial markets, and (e) the transparency of the price formation process in those markets. From this it should be clear that insider dealing is regarded as a threat to the UK financial system.

A definitive requisite for the integrity of the UK financial system is investors' confidence in UK capital markets leading to social well-being of the nation.[3] Those financial markets paying little to no attention to insider dealing, as it will be examined in chapter two, run the risk of losing their competitive advantages as investors will highly likely veer away to those financial markets promising longer spells of prosperity and higher degrees of protection. Confidence of investors in the integrity of UK financial markets amongst other things is maintained through the minimisation of the incidence of insider dealing, that is enforcement.

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[2] FCA, 'Mission Approach to Enforcement', April 2019. Sections 123 and 402 FSMA 2000

[3] FCA, 'Our positive impact 2023', 2023, and FCA, 'Our strategy 2022 to 2025', 9, 10. S Mills, 'How innovation and regulation in financial services can drive the UK's economic growth', Executive Director, Consumers and Competition, FCA, Speech Delivered at the CityUK Annual Conference, 29 June 2023. IOSCO, 'Credible deterrence in the enforcement of securities regulation', June 2015, paragraph 17(g). G Lawson, 'Efficiency and individualism' (1992) 42 Duke Law Journal 53. Within this thesis social wellbeing or social welfare is understood as how 'people feel about today and the future', Office for National Statistics, 'Measures of national well-being dashboard quality of life in the UK', 12 May 2023, and HM Treasury, 'Central Government Guidance on Appraisal and Evaluation', 2022, para 2.3. Further relevant discussion can found in C Goodhart, P Hartmann, D Llewellyn, L Rojas-Suarez, and S Weisbrod, *Financial regulation: why, how and where now*, (Routledge, London, 1998); D Llewellyn, 'The economic rationale for financial regulation, (1999) FSA, London; R A Posner, "Theories of Regulation" (1974) 5 Bell Journal of Economics 335

The thesis's central statement

The effectiveness of insider dealing regulations is achieved through or subject to enforcement being contingent upon the combination of deterrence criteria of certainty and severity of punishment.

The purpose of the thesis

To examine and evaluate the effectiveness of insider dealing regulations by investigating the challenges associated with enforcement shaping and affecting a deterrence-based enforcement strategy focusing on the civil regime against individuals.

The literature review

Much ink has been spilled about the effectiveness of insider dealing regulations, where this effectiveness is often derived from the level of harshness of insider dealing laws. Bris by analysing 4,541 acquisitions from 52 countries in a period between 1990 and 1999 reports that the prohibition of insider dealing increased its profitability, but the severity of sanctions tended to exhibit a decreased amount of insider dealing.[4] A similar conclusion was arrived at by Del Guercio and others, who observe that more aggressive enforcement of insider dealing laws in the U.S. deters insider dealing.[5] Durnev and Nain conduct a cross-sectional regression analysis

[4] This study relies on public information on abnormal volume and price movements in the 55 days ahead of the tender announcements, A Bris 'Do Insider Trading Laws Work?' (2005) 11 European Financial Management 267, see also In A Bris, 'Do insider trading laws work?' (2000) Yale ICF Working Paper 00-19. Seyhun in his examination of U.S. insider trading laws was less optimistic about the effectiveness '[I]increased statutory sanctions in the 1980s did not produce an additional deterrent effect either on the profitability or volume of insider trading', H N Seyhun, 'The Effectiveness of the Insider-Trading Sanctions' (1992) 35 Journal of Law and Economics, 149, 155

[5] D Del Guercio, E R Odders-White, and M J Ready, 'The deterrent effect of the Securities and Exchange Commission's enforcement intensity on illegal insider trading' (2017) 60 Journal of Law and Economics 269. In this study the authors carry out three tests for public enforcement of U.S. insider dealing laws. First, enforcement and price discovery is found to be positively correlated and is put down to the fear of prosecution. Second, preannouncement anticipatory run-up in comprehensive samples of takeover bids and earnings announcements is negatively related to enforcement intensity. Third, they find that quoted bid-ask spreads are negatively related to the enforcement intensity.

of 2,189 firms from 21 countries to find that on average stricter laws reduce the incidence of insider dealing.[6] Similar results but using different metrics are obtained in Beny, who studies 33 countries by deploying ownership concentration, stock price accuracy and market liquidity as the measures for insider dealing.[7] De Fond and others, relying on more than 50,000 annual earnings announcements in 26 countries find that in the countries with better enforced insider dealing laws annual earnings announcements are more informative.[8] According to Boardman and others, there is a positive correlation between a decrease in price run-ups and tightening insider dealing regulations in the U.S.[9] Similar trends are demonstrated in a study by Dutordoir and others, on price run-ups of U.S. target firms preceding merger and acquisitions announcement.[10] Bhattacharya and Daouk find that the cost of equity does not go down after the introduction of insider dealing laws, but it falls off after the first prosecution against insider dealing.[11] Fernandes and Ferreira, also show that first-time enforcement of insider dealing laws affects price informativeness, but it depends on a country's macro infrastructure.[12] Moreover,

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[6] A Durnev and A S Nain 'Does insider trading regulation deter private information trading? International evidence', (2006) 15 Pacific-Basin Finance Journal 409

[7] L Beny 'Do Insider Trading Laws Matter? Some Preliminary Comparatives Evidence' (2005) 7 American Law and Economics Review 144

[8] M DeFond, M Hung and R Trezevant, 'Investor protection and the information content of annual earnings announcements: international evidence', (2007) 43 Journal of Accounting and Economics 37

[9] A Boardman, Z S Liu, M Sarnat and I Vertinsky, 'The effectiveness of tightening illegal insider trading regulation: the case of corporate takeovers' (1998) 8 Applied Financial Economics 519. Similar conclusions can be drawn from U Bhattacharya, H Daouk, B Jorgenson, and C H Kehr, 'When an Event Is Not an Event: The Curious Case of an Emerging Market' (2000) 55 Journal of Financial Economics 69; J M Griffin, N H Hirschey, and P J Kelly, 'How Important Is the Financial Media in Global Markets?' (2011) 24 Review of Financial Studies 3941

[10] M Dutordoir, E Vagenas-Nanos, P Verwijmeren, and B Wu, 'A rundown of merger target run-ups' (2021) 50 Financial Management 487

[11] U Bhattacharya and H Daouk, 'The World Price of Insider Trading' (2002) 57 The Journal of Finance 75. In this study the authors used descriptive statistics, (mean returns, turnover, volatility), the international asset pricing factor model, changes in dividend yields, and country risk forecasts predictors

[12] N Fernandes and M A Ferreira, 'Insider trading laws and stock price informativeness' (2007) ECGI Finance WP 161. They analyse 48 countries over 1980-2003. The metric deployed for measuring price informativeness is firm-specific stock return variation The macro infrastructure encompasses the judicial system, investor protection, and financial reporting

Christensen and others, hold that more liquid markets post-Market Abuse Regulation (EU) of 2014 are located in the countries with the highest possibility of enforcement.[13]

Somewhat scarce is research regarding the effectiveness of the civil regime against insider dealing in the UK. Pham and Auslos look at abnormal returns in the price run-up to the first announcements of mergers between two regulatory periods, 2008 and 2012, and 2015 and 2019, that is, before and after the introduction of the FCA. They observe a reduction in the deployed metrics within the latter period concluding that the FCA is effective in regulating insider dealing.[14] These conclusions are however subject to several caveats, in particular, the words abnormal returns and insider dealing are used interchangeably, which are not synonyms as each of these factors can exist independently.[15] That is, abnormal returns can be earned for multiple reasons which are extraneous to insider dealing,[16] and insider dealing does not always guarantee abnormal returns. Concluding that the FCA is effective in regulating insider dealing regulations together with opining that no 'further tightening of regulation is practically required in the UK',[17] is as at minimum a hasty statement for there should be a deeper understanding of the workings of a civil deterrent effect, such as, an investigation into the actual enforced cases through the lens of deterrence theory. Gilbert and Tourani-Rad study 412 UK firms to find out whether the introduction of the civil regime in the UK has had a deterrent effect.[18] By deploying three measures of informed trading and two measures of price efficiency they find moderate evidence that the enactment of civil sanctions reduced informed trading following the introduction of the civil regime. The limitation of this study is that similar to all the other research cited in this section, there is no reference to the actual enforced cases of civil insider dealing, nor there is an examination and discussion of the assumptions of deterrence. Contrary

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[13] H B Christensen, L Hail and C Leuz, 'Capital-market effects of securities regulation: prior conditions, implementation, and enforcement' (2016) 29 Review of Financial Studies 2885

[14] R Pham and M Auslos, 'Insider trading in the run-up to merger announcements. Before and after the UK's Financial Services Act 2012' (2022) 27 International Journal of Financial Economics 3373

[15] Ibid

[16] For general discussion see G M Caporale and A Plastun, 'Abnormal returns and stock price movements: some evidence from developed and emerging markets' (2020) CESIfo Working Papers No. 8783

[17] Pham and Auslos (n 14), 3383

[18] A Gilbert and A Tourani-Rad, 'Do penalties matter? The impact of the introduction of financial penalties in the United Kingdom for insider trading' (2020) 52 Applied Economics 2622, 2633

to the Gilbert and Tourani-Rad's study, Panetsidou and others, show that the civil regime does not lead to a reduction in abnormal stock returns prior to takeover deals, but they argue that criminal sanctions are a deterrent.[19] The latter study does not go as far as to explicate what makes insider dealing laws stringent, how are they measured, instead, it is presumed that the introduction of the civil regime is representative of a stricter law.[20] However, these conclusions can be specious inasmuch as not only the law must be enforced to be effective,[21] but it can be extended to asserting that the law must be properly enforced to be effective. Lambe in his study on the pricing behaviour of successfully completed takeover target firm stocks within a period of 2000 to 2010 in the UK, contends that insider dealing regulations were ineffective as insider dealing continued to take place notwithstanding the enhanced legal powers and legislation.[22]

The identified gaps in the literature

Compellingly, the discussed findings predominantly converge upon a conclusion that the stricter the insider dealing regulations, the more effective they are in reducing the incidence of insider dealing. Effectiveness in those studies is implicitly or explicitly intertwined with deterrence.[23] In other words, the stricter is the regulation the more effective and deterrent it is, insinuating that this combination can palliate challenges to enforcement.[24] However, determining the cause and effect of deterrence in such studies is problematic because of the metrics, selected variables, and wider sets of parameters generating a configuration of effective insider dealing regulations if changed can produce different results. Ascertaining the

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[19] S Panetsidou, A Synapis, and I Tsalavoutas, 'Price run-ups and insider trading laws under different regulatory environments' (2022) 59 Review of Quantitative Finance and Accounting 601. In B Frijns, A Gilbert, and A Tourani-Rad, 'Do criminal sanctions deter insider trading? (2013) 48 The Financial Review 205, they by studying a criminal regime in New Zealand find that the introduction of criminal sanctions worsen the cost of trading, degree of information asymmetry and informed trading

[20] Ibid, 609

[21] U Bhattacharya and H Daouk, 'When no law is better than a good law' (2009) 4 Review of Finance 577

[22] B Lambe, 'Is insider trading regulation effective? Evidence from UK Takeover activity' (2012) 1 Journal of Governance and Regulation 24

[23] IOSCO (n 3) paragraph 4

[24] A Carvajal and J Elliot, 'The challenge of enforcement in securities markets: mission impossible', IMF Working Paper 09/168 2009

effectiveness of insider dealing regulations by anticipating a deterrent effect from enforcement rates is the same as predicting this deterrent effect, but predictions are difficult, and predictions are not similar to measurements.

Situating deterrence is a challenge in itself, not only because there should be a properly implemented enforcement policy, i.e., the potential penalty should be greater than the potential illegal gains,[25] but also due the difficulties associated with attributing deterrence to any given refrainment[26] for there can be other reasons for non-violation ranging from a computer glitch to an accident incapacitating the insider. At the heart of a deterrence-based enforcement strategy as this thesis will opine, resides a challenge of *believing* versus *hoping* that deterrence will be attained via this strategy given the assumption that an insider violates the law to make a profit,[27] including the other concomitant challenges impacting on enforcement, such as, sufficient legal powers to detect and enforce the law, effective enforcement approaches and a properly devised deterrence-based enforcement strategy.[28]

With this in mind, the findings obtained from such studies do not necessarily distinguish between illegal and legal insider dealing. This gap is salient as it can be expanded on and applied to the enforced cases where the abstruse notion of inside information[29] makes it not feasible for the enforcer of insider dealing regulations to be certain about the precise number of pieces of inside information being dealt in or disclosed legally or illegally. This implies three corollaries. First, given scarce economic resources and risk-based approach, the FCA cannot

[25] This will be thoroughly discussed in chapter six. P H Robinson, 'The difficulties of deterrence as a distributive principle', in eds. P H Robinson, S Garvey and K Kessler Ferzan, *Criminal Law Conversations*, (Oxford Academic, 2015)

[26] J Rakoff and J Eaton, 'How effective is US enforcement in deterring insider trading?' (1993) 3 Journal of Financial Crime 283

[27] M A O'Connor, 'Toward a more efficient deterrence of insider trading: the repeal of section 16(b)' (1989) 58 Fordham Law Review 310, 314; L A Jeng, A Metrick and R Zeckhauser, 'Estimating the returns to insider trading: a performance-evaluation perspective' (2003) 85 The Review of Economics and Statistics 453

[28] B J Adams, T Perry, and C Mahoney, 'Challenges of detection and enforcement of insider trading' (2018) 153 Journal of Business Ethics 375; P J Engelen, 'Structural problems in the design of market abuse regulations in the EU' (2007) 19 Journal of Interdisciplinary Economics 57

[29] H Davies, 'Information flow and market integrity', Chairman, FSA, Speech at the Bloomberg Lunch, 25 October 2000; A Padilla, ‘Can Regulation of Insider Trading Be Effective?’ (2005) Bepress Legal Series*,* Working Paper 654; A Padilla, ‘Should the Government Regulate Insider Trading? (2011), 22 Journal of Libertarian Studies 379

act on every potential instance of insider dealing. Even if the FCA wields sufficient legal powers to enforce the law there pointing to a relatively high level of certainty of detection, but with still a relatively low certainty of enforcement. This consideration is applicable to both the regimes. Second, by extension, the FCA cannot constantly be sure as to the accuracy of quantified illegal gains from insider dealing for the purposes of constructing a deterrent civil financial penalty.[30] Third, the significance of enforced cases is that would-be offenders observing financial penalties which are not exhibiting a deterrent, may perceive that the certainty and severity criteria of deterrence are undercut.[31]

While there is some evidence pertaining to the potential criminal regime's deterrent effect, mainly owing to overall deterrence theory research,[32] to date there is little research on the civil regime's deterrent effect as a self-standing disincentive and in combination with the former one, and there is no conspicuous research examining the actual enforced cases. The civil regime is an equally consequential instrument for preventing insider dealing as it was introduced to complement the criminal regime,[33] which in its turn was enacted to invoke general deterrence meaning that a certain and severe punishment was supposed to discourage would-be offenders from violating.[34] Prior studies have failed to comprehensively consider a distinct set of sanctions and penalty-setting mechanism that the civil regime implements, therefore the expectations of deterrence cannot be immediately extrapolated to civil cases as it can create a fallacy of composition. To put it more simply, if surmising that the criminal law is

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[30] H G Manne, 'Efficient Markets and Insider Trading' (1984) Centre for Economic Analysis of Property Rights, The University of Western Ontario

[31] This discussion will be elaborated on in chapter five

[32] See chapter five

[33] The criminal law's standard of proof has frequently been disparaged in the literature for its cumbersomeness, see P Engelen, 'Difficulties in the criminal prosecution of insider trading - a clinical study of the Bekaert case' (2006) 22 European Journal of Law and Economics 121; M Duffy, 'Insider trading: addressing the continuing problems of proof' (2009) 23 Australian Journal of Corporate Law 149; J Oberg, 'Is it 'essential' to imprison insider dealers to enforce insider dealing laws?' (2014) 14 Journal of Corporate Law Studies 111; D Kirk, 'Enforcement of criminal sanctions for market abuse: practicalities, problem solving and pitfalls', (2016) 17 ERA Forum 311. In R Tomasic and B Pentony, 'The prosecution of insider trading: obstacles to enforcement' (1989) 22 Australian and New Zealand Journal of Criminology 65, 77, the interviewed regulators did not believe that the civil law's standard of proof would be easier to meet that the criminal standard of proof

[34] See chapter three

a deterrent, and the civil regime was introduced to complement the former one, hence the civil regime is a deterrent too, but there is no robust evidence of that.

These regimes are not dissimilar to each other as they share homogenous elements of the insider dealing offence in the sense that the FCA can manoeuvre across the regimes. The differences between the civil and criminal regimes will be touched upon in chapter four, but the overarching argument that this thesis will be built around is as follows, with the certainty of detection and punishment is analogous between the regimes, it is the severity of punishment that differs dissecting this subtle line between the regimes evincing uncertainties as to whether a civil regime can deliver deterrence.[35]

Considering that there is little to no research dealing with the effectiveness of insider dealing regulations through the challenges to enforcement focusing on the severity criterion of civil sanctions against individuals given a relatively low certainty of enforcement, this PhD initially had faced the following research opportunities:

* Explore the deterrent effect of civil sanctions against individuals, or firms or together.

* Explore the deterrent effect of a criminal sanction.

* Explore the deterrent effect of civil sanctions against individuals, or firms or together in the presence of a criminal sanction.

* Explore the deterrent effect of a criminal sanction in the presence of civil sanctions against individuals, or firms or together.

Based on the aforementioned literature and gaps therein, this thesis will, while examining the overall insider dealing regulatory framework in the UK, focus on the challenges to the effectiveness of insider dealing regulations by focusing on the civil regime against individuals. Without comprehending the potential deterrent effect of civil sanctions which were introduced to complement the criminal regime and given the relevant challenges to enforcement which impede the effectiveness of regulations irrespective of the regimes, any conclusion as to the effectiveness of insider dealing can be compromised on the grounds of shallowness. Thus, in order to determine the effectiveness of insider dealing regulations this thesis will contend there ought to be firstly an examination of the challenges to enforcement focusing on the civil regime's penalty-setting framework against individuals.

[35] Deterrence is the principle of the FCA's penalty-setting regime, DEPP 6.5.2(3)[G]

1.2. The research questions

This thesis will aim to answer two overarching questions broken down below. Each of these questions will be answered by addressing a series of sub-questions directed at studying the effectiveness of insider dealing regulations in the UK. A more detailed summary of the research questions will be provided in section 1.4. and section 1.5.

Question One

What are the challenges to enforcement of insider dealing regulations?

Sub-questions:

(a) What are the justifications for insider dealing regulations, are they theoretically and empirically robust?

(b) Can any given theoretical assumption, model, theory and the like, dictate the nature of financial regulator(s) attitude towards insider dealing regulations regardless of their compatibility?

(c) What are the environments in which insider dealing has been evolving as a legal concept?

> **(c)(i)** what was the purpose of the introduction of the civil regime?,
>
> **(c)(ii)** did (does) the civil regime's standard of proof and length of prosecutions differ from the criminal regime's?

(d) Do the elements of insider dealing, or the law on insider dealing itself challenge enforcement?

(e) Does the FCA wield sufficient legal powers to detect and enforce insider dealing regulations?

(f) What is the existing civil's regime penalty-setting framework?

Question Two

Is (can) deterrence (be) a suitable response to insider dealing?

Sub-questions:

(g) Does the existing civil's regime penalty-setting framework against individuals deliver deterrence? Alternatively, this question can be formulated as follows, how far does the civil penalty-setting framework reflect the expectations of insider dealing regulations?

(h) Is the magnitude of a financial penalty conditional on the impact factor under FCA's Decision Procedure and Penalties Manual 6.5C.2[G](11)(a)?[36]

1.3. Methodology

Straddling financial economics and law insider dealing is a complex and controversial phenomenon. Due to this complexity, this research will examine the effectiveness of insider dealing regulations by harnessing legal, financial economics and political economy research, statistical techniques and criminology. Inter-disciplinarity will enable this thesis to not only critically engage with the identified challenges to enforcement, but also put forward innovative economic techniques for inferring deterrence from civil financial sanctions that heretofore have been overlooked. A more detailed explanation and justifications for devising and deploying these techniques will be conducted under the heading chapter six below, and in chapter six, in particular, sections 6.1., 6.2. and 6.3.

As far as the underlying approach is concerned, this thesis will resemble a reductionist approach[37] in that it will separate out the research questions into two_basic sets of challenges.

[36] The level of benefit gained, or loss avoided, or intended to be gained or avoided by the individual from the market abuse, either directly or indirectly

[37] Reductionism is frequently used in physics, mathematics, biology, psychiatry, but also in law, see for example, C Sachse, *Reductionism in the philosophy of science*, (De Gruyter, 2013); T Brown and L Smith, Reductionism and the development of knowledge, (Taylor and Francis Group, 2022); J d'Aspremont, 'Reductionist legal positivism in international law' (2012) 106 Proceedings of the Annual Meeting (American Society of International

More detailed discussion on these two basic sets will take place in section 1.4., but here it is necessary to outline their structure. The first set of challenges can be understood as the challenges originating in the ambiguous nature of insider dealing, which will envelope questions (a) and (d). The second set of challenges will encompass the rest of the questions and can be understood as the challenges which can be rectified by the Financial Conduct Authority (the FCA).

In view of the fact that this thesis will be inter-disciplinary in nature, i.e., some chapters, as it will be summarised below, will take on different methodological approaches, and lest confuse the reader, any relevant literature review, if any, apart from the one discussed in the preceding section will be contextually intertwined within the chapters.

Chapter Two

Will aim through reasoning to answer questions (a) and (b). This chapter will be based on the relevant financial economics literature, such as, the justifications for insider dealing regulations and the efficient market hypothesis.

Chapter Three

Will aim to answer question (c). By looking at the historical developments in insider dealing regulations in the UK, this chapter will identify the challenges to enforcement and mention what had been implemented to attenuate such problems. Concerning sub-question (c)(ii), this chapter will statistically compare the length of civil prosecutions to that of the criminal prosecutions. The following methodology will be devised,

Data collection

The data pertaining to the length of prosecutions for the civil cases for a period from 2004 to 2021 will be collected using traditional legal methods by analysing the Final Notices issued by the Financial Services Authority (hereinafter the FSA), the predecessor to the FCA, and the FCA. As regards the criminal regime, given that there is a paucity of information on

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Law), Confronting Complexity 368; S D Smith, 'Reductionism in legal thought' (1991) 91 Columbia Law Review 68 the cases accomplished in the 1980s and 1990s, the author complied the data from the National Archives and Hansard UK Parliamentary archives.[38] More recent cases, enforced by the FSA and the FCA will be obtained from the FCA website.[39]

Data analysis

The collected data for the period from 2000 to 2021 will be compared between the regimes. First, the indicated date of commission of insider dealing against which either a criminal or civil sanction was imposed will be subtracted from the date of the final judgement for criminal cases and final notices or tribunal decisions for civil cases. The difference will therefore reveal the duration between the commission of insider dealing and the sanction. However, as it will be pointed out in chapter three, this methodology is subject to several caveats. It is prudent to have this difference differentiated between actual and observed. This thesis will deal only with what can be observed by anyone carrying out research. The actual difference may be different inasmuch as there is no statute of limitations in the insider dealing law, so the indicated date of insider dealing does not imply that the FCA commenced an investigation into the matter on that particular date.

Chapter Four

Will aim to answer questions (d), (e) and (f). These questions will be dealt with by examining and analysing the elements of insider dealing, in particular the problematic notion of inside information. The existing legal powers available to the FCA will be examined from two angles, the certainty and severity of punishment. Here the focus of this thesis will narrow down to the civil regime, where a civil penalty-setting framework will be analysed.

[38] The National Archives can be accessed at https://www.nationalarchives.gov.uk/. House of Commons Hansard archives can be accessed at https://www.parliament.uk/business/publications/hansard/commons/

[39] FCA can be accessed through https://www.fca.org.uk/

Chapter Five

Will aim to answer question two. In order to answer this question, this thesis will explore and analyse the assumptions of deterrence theory, namely, the certainty and severity criteria of punishment, rational decision making when facing risky and uncertain choices, Becker's model of economic crime and optimal sanctions given the low certainty of enforcement in the presence of the criminal regime and without.

Chapter Six

Will aim to answer questions (g) and (h). In order to answer question (g), this thesis will propound a unique two-step metric or algorithm for evaluating deterrence in civil financial sanctions.

Justifications for using this approach

The two-step metric for evaluating a deterrent effect from civil financial sanctions to be propounded in this thesis is unique in how it is built and how it derives a deterrent effect from financial sanctions. Several significant contributions to the existing knowledge of evaluating the effectiveness of insider dealing regulations will made by applying the two-step metric to the enforced civil cases. This original approach is justified for the following reasons,

(1), the two-step metric builds in the challenges to enforcement, or the assumptions to be outlined in the next sub-section,

(2), the challenges with locating deterrence are countervailed by observing deterrence in the meted out penalties given a level of certainty of punishment,

(3), given that financial sanctions are pecuniary, it is therefore possible to devise an algorithm(s) capable of deriving a deterrent effect from monetary sanctions.

Assumptions

The proposed two-step metric will be based on certain assumptions, such as,

(1) the FCA runs up against the quantification issue when imposing a financial penalty, i.e., such a penalty can imprecisely reflect the actual amount of illegal gains from insider dealing.

(2) disgorgement,[40] as a financial penalty component under the FCA's Decision Procedure and Penalties Manual (hereinafter DEPP) 6.5C.1[G], can be inaccurately quantified.

(3) a penalty reflecting the seriousness of insider dealing (hereinafter PRSID) under 6.5C.2[G] DEPP, is subject to numerous factors, where one impact factor under 6.5C.2[G](11)(a), namely, 'the level of benefit gained or loss avoided, or intended to be gained or avoided the individual from the market abuse, either directly or indirectly' (hereinafter the impact factor).

(4) given that insider dealing is about generating profits, the impact factor should be prevailing as it represents the quantified amounts of such illegal gains.

(5) the impact factor constitutes the same figure as that of disgorgement, that being said, the quantified illegal gains can influence the PRSID giving rise to the possibility of having a financial penalty lower than the quantified illegal gains thereby violating the assumptions of a deterrence-based enforcement strategy.

Data collection

The two-step metric will therefore be restricted to those civil cases (n 32) where both disgorgement and a PRSID, and/or only disgorgement were meted out. The data will be collected from the relevant Final Notices, i.e., containing the aforementioned sanctions, issued by the FSA and the FCA between 2004 and 2021. Although, this two-step metric rests on the assumptions designed for DEPP, its algorithms can also be deployed in the criminal regime.

Two-step metric application

In the first step the collected cases are categorised into the following groups,

[40] Disgorgement is the deprivation of quantified illegal gains from insider dealing

First group. A financial penalty is greater than the quantified illegal benefits,

Second group. A financial penalty is smaller than the quantified illegal benefits,

Third group. A positive financial penalty break-even point.

The allocation to the groups will be carried out by subtracting the disgorgement figure from the total financial penalty. The resulting difference will then be subtracted from the PRSID to be compared against the quantified illegal gains. Logically, since the disgorgement figure equals the impact factor figure, this figure is twice referred to, and disgorgement will be eliminated at this step for grouping is a measure for disgorgement.

In the second step the first and second groups will be used to derive a deterrent rate by dividing a PRSID by the difference from the PRSID and the impact factor thereby solving now for the PRSID. The deterrent rate which falls within the value of 1 represents the first group. Conversely, for the second group the value of a deterrent rate can fall everywhere even in the domain of negative numbers but not within the value of 1.

Question (h) will be answered by applying a one-way ANOVA test to statistically examine the impact factor against the three penalty groups.

Data collection

The impact factor will be broken down into two variables, the total number of shares traded, or orders placed and the bid-ask spreads. The enforced civil cases irrespective of the financial penalty's components for a period between 2004 and 2021 will be examined. The Final Notices will therefore be scoured for those cases containing both the variables. The total of 30 civil cases satisfied the inclusion criteria.

Data analysis

A one-way analysis of variance (hereinafter ANOVA) test will be conducted on IBM SPSS version 27. One-way ANOVA is an analysis of variance used to find out any statistically significant differences between the means of three or more unrelated groups. The p-value will be set at 0.05.[41] In order to carry out this test the three assumptions will be met first, namely, (1) the assumption of normality, i.e., data are normally distributed, (2) the assumption of homogeneity of variance and (3) the assumption of independence of observations.[42] Concerning the first assumption the collected data as it will be initially left skewed will undergo a log10 transformation to fulfil the normal distribution assumption. After that each variable will be tested against the three penalty groups.

1.4. The focus of the research

This thesis will understand the effectiveness of insider dealing regulations as a cyclic process. In the same vein as the literature discussed in section 1.1., the effectiveness of regulations comes about as a product of enforcement, including a threat from enforcement,[43] where the ultimate goal is to supply deterrence which then feeds back into the effectiveness of regulations, i.e., would-be offenders do not contravene the law. It follows that, the effectiveness of insider dealing regulations is centred on the success of a deterrence-based enforcement strategy. Without enforcement, or when enforcement is compromised on account of various challenges, or incorrectly applied deterrence strategies, deterrence is undermined too consequently chipping away at the integrity and investor's protection objectives.[44]

In the constantly evolving financial markets landscape, the already identified and even confronted challenges can crop up repeatedly in defiance of the counteractions undertaken to mitigate them, this dynamism is pregnant with yet to be identified challenges corroding the

[41] p-value shows the level of statistical significance

[42] D C Howell, *Fundamental statistics for the behavioural sciences*, (5th edn, Thomson Wadsworth, 2004), 356

[43] Bhattacharya and Daouk (n 21); IOSCO (n 3) paragraphs 5 and 10, rightly argues that 'An effective deterrent framework would guarantee that those who engage in misconduct will be detected, prosecuted and sanctioned, and will receive no personal benefit from their wrongdoing. However, it is unrealistic to expect that any system could ever, in absolute terms, accomplish this goal, no matter how many resources are dedicated to achieving it. Therefore, regulators need to examine workable strategies that maximise the prospects of delivering credible deterrence in a risk-based environment', FCA, Business Plan 2023/2024

[44] IOSCO (n 3), paragraph 11; D Mookherjee and I P L Png, 'Marginal deterrence in enforcement of law' (1994) 102 Journal of Political Economy 1039, aptly put that 'Laws and regulations to guard the public interest are respected only to the extent that they are enforced'

objectives of enforcement, that is, lowering deterrence. Understanding such challenges through the lens of effectiveness, which is the product of a deterrence-based enforcement strategy, can provide a valuable insight into the effectiveness of insider dealing regulations. But this thesis will not aim to touch upon, identify or examine all potential challenges ascribable directly or indirectly to insider dealing, instead this PhD will focus on the enforced civil financial sanctions and the two sets of challenges. The first set will be understood as those challenges being inherent to the nature of insider dealing,[45] such as, the elusive character of inside information which all will be reduced to the issue with quantification of illegal gains from insider dealing. Such challenges are inalienable constitutes of insider dealing.

The second set encapsulates the challenges which are not intrinsic and as evidenced by the historical developments they can be rectified by the FCA, for example, the availability of effective detection tools to spot insider dealing, enforcement policies and approaches and so on. Both the sets of challenges are interconnected. The intrinsic challenges should above all be considered in the process of imposing a penalty, whereas the rectifiable challenges more pertinent to the level of certainty of enforcement. Since the FCA cannot act on every potential instance of insider dealing, the severity of punishment criterion should compensate for a low certainty of enforcement. Here these two sets overlap, the certainty and severity criteria of punishment should be inversely related, as it will be argued in chapter five.

1.5. The overview of the contributions and findings

By examining the effectiveness of insider dealing regulations through the two sets of challenges to enforcement and presenting a novel form evaluation of the level of deterrence of a civil financial sanction, this thesis will conclude that insider dealing regulations in the UK cannot be deemed effective for the application of the civil regime's penalty-setting framework may

[45] The primary argument for incorporating various exemptions, defences and so on, is not to stifle financial innovation, this will be touched upon in chapter two. See for example, K Kogan, D Papanikolau, A Seru and N Stoffman, 'Technological innovation, resource allocation and growth' (2017) 132 Quarterly Journal of Economics 665, who finds that innovation positively influences market values of firms. Stricter insider dealing laws are said to reduce incentives to engage in innovation, K Hussinger, J M H Dick and D Czarnitzki, 'Ownership concentration and innovativeness of corporate ventures' (2018) 47 Research Policy 527

have undermined the deterrence-based enforcement strategy. Below are the main findings and contributions of the research,

(1) the challenges to enforcement of insider dealing regulations can be analysed and examined through two basic sets of challenges. The first set, as this thesis argues, contains the challenges which cannot be eradicated, that is those challenges being intrinsic to the nature of insider dealing, such as, the problematic notion of inside information and legality of insider dealing in certain circumstances bringing about a quantification issue. This issue implies that the FCA cannot be certain as to the correctness of quantified amount of illegal gains. The second set of challenges represents those challenges which can be rectified by the FCA, for example, the legal powers to detect and enforce insider dealing regulations, effective enforcement policies and approaches. This differentiation between these two sets is important because this thesis will regard the former set as the severity of punishment, and the latter set as the probability of punishment,

(2) to determine the effectiveness of insider dealing regulations it is necessary to explore and analyse the assumptions of deterrence theory underpinning insider dealing regulations in the UK. The research finds that a deterrence-based strategy to enforcement is a suitable response to combat insider dealing, but if and only if such a strategy is properly devised and deployed. Given that the certainty of punishment is relatively low, since not every instance of insider dealing can be identified and investigated, the severity of punishment should be amplified in those cases being enforced. For situations where both a criminal and a civil sanction may be imposed an optimal combination of a sanction is the maximal financial penalty, should the insider be unable to afford the fine, a criminal sanction should be imposed. This thesis focuses on the civil regime's penalty-setting framework bearing in mind the quantification issue argues that a financial sanction should be set to be at least greater than the quantified/potential illegal gains.

(3) situating deterrence for the purposes of ascertaining the effectiveness of insider dealing regulations is an arduous task, but it can be observed not through the overall enforcement, but through the actual severity of punishment in enforced cases. Focusing on the civil regime against insider dealing and building on the quantification issue and other concomitant challenges to enforcement, this thesis evaluates the deterrent effect of civil sanctions using an original two-step metric. These pioneering algorithms significantly differ from the existing approaches to deducing deterrence, in that it (1) they adopt an economic modelling approach to a topic traditionally addressed through other methods, (2) they are

constructed on certain assumptions focusing on the enforced civil cases, which can provide a better picture of what would-be insiders observe in terms of the severity of punishment given a low certainty of enforcement and (3) they can be deployed in criminal cases as well after having been adjusted for the assumptions. The results obtained from the two-step metric show that the effectiveness of insider dealing regulations is undermined on the foot of the proportionality principle,[46] i.e., a financial sanction can be lower than the quantified illegal gains. To put it differently, a financial penalty consisting of both disgorgement and a penalty reflecting the seriousness of insider dealing under the civil regime's penalty-setting framework can be disproportionately small in relation to the quantified illegal benefits,

(4) the civil regime's penalty-setting framework may have contradicted the assumptions of deterrence, namely, in line with DEPP, a financial sanction should be greater than the quantified illegal gains, but in practice it is not the case because of the issue with quantification of illegal gains, and the controversial nature of disgorgement in relation to the penalty reflecting the seriousness of insider dealing. As a result, under the civil regime's penalty-setting framework a financial penalty can be disproportionately imposed, thence people's cost-and-benefit considerations are not positively incentivised,

(5) another way of determining the effectiveness of insider dealing regulations is by statistically evaluating the impact factor under DEPP 6.5C.2(11)(a). The thesis argues that this factor should be evaluated first and independently inasmuch as it is premised on the fundamental elements of the insider dealing offence, that is, price-sensitivity of inside information in relation to financial instruments and the insider's aspiration to financially capitalise on that inside information either to profit or to avoid losses. Even in cases of improper disclosure, where it is possible that the insider divulging that inside information to a third party does not intend to violate the law, this third party can potentially go on to deal in, further disclose or encourage another to use that price-sensitive inside information. For this reason, this thesis observes no statistically significant relationship between this impact factor standing alone and the magnitude of a financial penalty. Removing the disgorgement figures from the test will show even a greater disassociation between the impact factor and the severity of sanctions.

[46] DEPP 6.5.3[G](3), and Enforcement Guide 2.1.2(2)

1.6. Regulatory uncertainties

In closing, changes to the UK financial regulatory system are afoot. Having steamrolled through Parliament the Financial Services and Markets Act 2023 revoking retained EU law, the Government have created a once-in-a-generation opportunity to tailor financial regulations to fit UK markets.[47] Every so often overhauling the financial regulatory framework is imperative,[48] to the effect that the challenges as active as latent impeding the effective implementation of the FCA's integrity objective are identified, evaluated, and efficiently tackled.

In furtherance to the Future Regulatory Framework Review,[49] a joint statement from HM Treasury and the FCA came out on the 24th of March 2023 indicating that UK MAR would be replaced by UK-specific legislation.[50] No specifics have been provided in this statement, but it has been announced that the new regime on post-trade transparency requirements will come into force in April 2024.[51] On the whole, some regulatory and legislative changes are possibly going to have been introduced by the time this thesis has been examined, but it is unlikely that such changes would have a considerable bearing on the assumptions and proposals put forward in this work, unless insider dealing was suddenly legalised, or the civil regime abolished once and for all without replacement. Even under such improbable scenarios, the

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[47] HM Treasury, Press Release, 'Rocket boost for UK economy as Financial Services and Markets Bill receives Royal Assent', 29 June 2023

[48] H Davies, 'Why regulate?', Chairman, FSA, Speech at the Henry Thornton Lecture City University Business School, 4 November 1998

[49] HM Treasury, 'Financial services future regulatory framework review: Proposals for reform' (2021) CP 548

[50] Joint HM Treasury and FCA, 'Statement on the Criminal Market Abuse Regime', 24 March 2023, available at https://www.gov.uk/government/publications/joint-hm-treasury-and-fca-statement-on-the-criminal-market-abuse-regime/joint-hm-treasury-and-fca-statement-on-the-criminal-market-abuse-regime, accessed on 11 June 2023

[51] FCA, 'Improving equity secondary markets' (2023) Policy Statement 23/4; HM Treasury, 'Wholesale markets review: consultation', July 2021; HM Treasury, 'Wholesale Markets Review: Consultation Response', 1 March 2022. Likewise, the FCA in its Business Plan 2023/2024 informs that further work on transparency of persons discharging management responsibilities is being undertaken to help limit insider dealing by combatting unlawful disclosure

suggestions produced by this thesis can be generalised and applied to other similar regulatory frameworks.[52]

[52] For instance, the Prudential Regulatory Authority's and the Competition Markets Authority's penalty-setting framework is similar to that of the Financial Conduct Authority's against insider dealing

CHAPTER TWO

The Basic Challenges: the Justifications for Insider Dealing Regulations

This chapter will aim to examine sub-questions (a) and (b). Regarding (a), this chapter will explore whether the justifications for regulating insider dealing are theoretically and empirically robust. The following arguments will be examined, diminished investors' confidence in the fairness and cleanliness of the financial markets, dried-up financial markets liquidity, the principal-agent problem and the social-wellbeing argument. In relation to question (b), this chapter will discuss whether the assumptions of the efficient market hypothesis of financial markets have affected the attitudes of UK financial regulators towards insider dealing.

With respect to (a), it will be argued that the existing academic literature is not unequivocal about the deleterious impact of insider dealing.[53] But this thesis will reason that, if there is a plausible likelihood of diminished social wellbeing as a result of insider dealing, the prohibition of insider dealing is warranted at least until there are sufficient data showing the contrary. Concerning question (b) it will be necessary to understand how the efficient market hypothesis, calling for financial markets autonomy with minimal or no regulatory intervention, has affected the justifications for regulations. It will be asserted that over-reliance on theoretical models in the financial regulatory context can lead to misinterpretation and misapplication of these very models. Using the efficient market hypothesis, which has been theoretically and practically substantial to our understanding of financial markets, will reveal this hidden but arguably a fundamental challenge of ignoring other theoretical structures offering alternative ways of describing and modelling reality. This challenge gives a sense of unease as it will be discussed in chapter three, enforcement strategies and thereby the integrity and investor protection objectives can be contingent on the assumptions of a theory which can potentially lead to a regulatory failure.

[53] S Bainbridge, 'The insider trading prohibition: a legal and economic enigma' (1986) 38 University of Florida Law Review 35

2.1. Confidence of uninformed investors

2.1.1. Defining the importance of confidence in financial markets

Confidence of market participants can be understood as how they view the financial markets' macro and microstructure, that is, the level of integrity and transparency of financial markets,[54] the accuracy of price formation process, the prevalence of fraud, market manipulation, insider dealing, and other types of misconduct, and how prompt and effective is the financial regulator in maintaining the normal operations of markets, detecting and dealing with financial misconduct.[55]

Diminished confidence in the integrity will have a negative effect on the whole economy of the UK.[56] To understand the scale of such a negative repercussion consider that the UK has external liabilities of over 550 per cent of GDP.[57] A decline in confidence can bring about massive falls in UK asset prices, tighter domestic credit conditions, and weakened sterling exchange rate.[58] Such dipped confidence can thus lead to higher borrowing costs for the government, businesses, and households thereby lowering their resilience. It can be anticipated that hundreds of small and medium enterprises (hereinafter the SMEs) will run into corporate distress being unable to roll over or refinance existing debt or issue new finance.[59] Many SMEs will go bust or embark upon deleveraging through downsizing or reducing investment, in any event, both scenarios are bad for social wellbeing.

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[54] HM Treasury, Bank of England and FCA, 'Fair and effective markets review' Final Report June 2015, 9. Investor Confidence in the UK energy sector 2016, 7

[55] J Hogget, 'Effective compliance with the market abuse regulation -a state of mind', Director of Market Oversight at the FCA, Speech delivered at the 'Recent developments in the market abuse regime' conference, 14 November 2017

[56] FCA, 'Enhancing market integrity', 17 February 2023

[57] Financial stability report, December 2022, Bank of England, Box A: UK external balance sheet vulnerabilities

[58] Ibid. Foreign investors are estimated to own around 50 per cent of UK equity and private sector debt, 30 per cent of UK government bonds, and 40 per cent of the value of UK CRE transactions in any given year

[59] Ibid

2.1.2. Measuring confidence and victims of insider dealing

This section begins with the assumption that nothing of the aforementioned is actually attributable to insider dealing, because insider dealing is a victimless crime.[60] In order to find out whether there is a victim to insider dealing or not, it is important to be able to reliably measure confidence of investors, which is problematic.[61] In this connection, a study conducted by Green and Kugler shows that respondents from all walks of life, are of an opinion that insider dealing should be prohibited but they struggle to define who is 'wronged or harmed by such conduct...'.[62] In general, there are a few ways how confidence of investors can be measured. For example, the CBOE's Volatility Index (VIX) or State Street Investor Confidence Index.[63] Bain & Company, although without referring to insider dealing, carried out a survey study in which they ask large U.S. institutional investors whether their confidence in UK markets is growing or dwindling.[64] Confidence of investors is often referred to as 'risk appetite', that is, about taking additional risk with the expectation of generating profits.[65]

[60] H G Manne, *Insider trading and the stock market*, (The Free Press, New York, 1966); B Rider, 'The Control of Insider Trading-Smoke and Mirrors!', (2000) 19 Penn State International Law Review, Article 2; H McVea, 'What's wrong with insider dealing?' (1995) 15 Legal Studies 390; P M DeMarzo, M J Fishman and M Kathleen, 'The Optimal Enforcement of Insider Trading Regulations' (1998) 106 Journal of Political Economy 602

[61] FCA, Outcomes and metrics, 2 April 2022, paragraph 4.6

[62] S P Green and M B Kugler, 'When is it wrong to trade stocks on the basis of non-public information?' (2011) 39 Fordham Urban Law Journal 445, 484

[63] CBOE stands for the Chicago Board Options Exchange and VIX is volatility index. This index measures the volatility of options on the S&P 500. The State Street Investor Confidence Index looks at the trading and risk behaviour of large institutional investors

[64] P Foster, 'US business confidence in the UK slides' FT, London, 12 June 2023. A survey conducted by Bain & Company in 2023 show that the respondents, mainly large US institutional investors rate 7.0 out of 10.0, the first Transatlantic Confidence Index. See also J Frick, D Edwards, and E Adam, 'The UK-US corridor is strong, despite US drop in confidence in the UK' June 12, 2023, Bain & Company

[65] P Gai and N Vause, 'Risk Appetite: Concept and Measurement', Bank of England Financial Stability Review, December 2004; P Gai and N Vause, 'Measuring investors' risk appetite' (2006) 2 International Journal of Central Banking 167

Measuring investors' confidence due to insider dealing has two issues, there is little research on this matter[66] and these confidence levels are difficult to gauge, because there are other events should be factored in determining any statistical relationship. The FCA has in its Practitioner Panel Survey Report for 2022/2023 devised several metrics which can shed some light on how market participants perceive the insider dealing threat. In particular, the market integrity metric denoted by AMA1-M01, in question Q62b, the market participants are asked to scale the effectiveness of the FCA in protecting UK markets from insider dealing. The obtained results are as follows, 65 per cent of the respondents think that the FCA is very effective, six per cent of the respondents are not sure, and 29 per cent believe that the FCA is not very effective in combatting insider dealing. In another metric AMA1-M02 on market cleanliness, the market participants in question Q61 are asked the following question, how much of an issue do you believe market abuse is in the UK? The obtained results indicate that 47 per cent believe that market abuse is a big or fairly big issue, 37 per cent think it is not a big issue or not an issue, and 15 per cent think it is an issue. Then in question Q63 on the effectiveness of the FCA to combat market abuse as compared to other regulators in other global markets, the responses are such that 42 per cent deem the FCA to be more effective, 22 per cent think about the same, and 34 per cent do not know or think that the FCA is worse.[67]

Although, this survey does not tell precisely who is the victim of insider dealing, it can be deduced that everyone who is not in possession of inside information is a potential victim regardless of whether they have suffered a direct loss from that insider dealing. This argument can be substantiated by the fact that in the UK it is not allowed to file a lawsuit against an insider in insider dealing cases, unless of course there was a face-to-face transaction with identifiable counterparties. In other words, since the victim status from insider dealing is barely feasible to determine, then everyone within the UK jurisdiction may be a victim of insider dealing. Another way of looking at this argument that everyone is a victim is that insider dealing can be legal in certain circumstances, as it will be discussed in chapter four. Cogently, insider dealing's legality creates a moral problem in that, if for whatever reasons insider dealing is allowed in one instance, it can also be vindicated in another instance, likewise for whatever

[66] J P Anderson, 'Insider trading and the myth of market confidence' (2018) 56 Washington University Journal of Law and Policy 1

[67] FCA, Practitioner panel survey, 2022-2023 Report, July 2023. This survey was conducted amongst CEOs and/or Heads of Compliance from a range of different financial organisations regulated by the FCA, page 6

reasons. In chapter four there will be examples of the actual cases where 'insiders' were let off on the grounds of them not knowing that they had had inside information.[68] In essence, it means that, irrespective of whether a person knew that it was inside information or not, this constraint leads to two potential outcomes, the insider may keep the illegal benefits, and public confidence in the fairness of financial markets may have been undercut.

Imagine a situation where an insider makes a profit from insider dealing. The insider then puts these profits into a socially positive cause. Say, the insider finances ten expensive surgeries for orphans. Should this benevolent insider be punished? If yes, then how can we justify the exculpation of insiders generating profits ostensibly not knowing that they had inside information, and then go on to punish insiders who knew that they had inside information but channelling their still illegal profits to benevolent deeds? As a matter of fact, in chapter four it will be concluded amongst other things that, insider dealing as a legal construct, although the Government have been intent on expanding the scope of the offence, is circumscribed by multifarious exemptions, defences, legitimate behaviours, and so on, challenging the implementation of the law. In this smorgasbord of at times mutually exclusive and inclusive legal rules intertwined with legitimate financial businesses situating diminished confidence as a result of insider dealing is barely feasible. But even if it is true that in this hypothetical example the insider's action increases the overall welfare of society, it is still uncertain whether this very action undermines Pareto optimality, i.e., makes the wellbeing of other unidentified individuals worse off.[69]

The issue with this idea of optimal re-allocation of resources, as in this example, the insider's transfer of wealth to those economically vulnerable probably affects the wellbeing of others. These 'others' are the public, society, or simply everyone who may have suffered from this re-allocation but may have been not. Getting ahead of time, in chapter five, this thesis will arrive at a conclusion devoid of emotional sentiments, where a penalty should always be greater than the quantified illegal gains making up for a low certainty of punishment. This conclusion

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[68] According to section 57(1)(a) of the CJA 1993, an insider has information as an insider if and only if it is, and he knows that it is, inside information, he has it, and knows that he has it, from an inside source. As regards UK MAR, recital 26 sets down a similar constraint where a person who knows, or ought to have known, that the information constitutes inside information

[69] J Francis, *The Politics of Regulation: A Comparative Perspective*, (edn, Blackwell, 1993); M Fujimura and J Weiss, 'Integration of Poverty Impact in Project Economic Analysis: Project Economic Analysis' (2000) Asian Development Bank, Philippines

is relevant to this discussion as it will rest on the three underlying points. First, allowing virtuous insider dealing can attract unscrupulous insiders camouflaging their criminal intentions in praiseworthy activities. Differentiating between good and bad insiders will derail the purpose of insider dealing regulations, that is, the protection and maintenance of integrity. Second, it will be barely possible to deduce a Kaldor-Hicks improvement, in which, economically speaking, for example, those orphans having had surgeries will pay compensation to those unidentified worse off investors thereby improving the welfare of both.[70] Third, insider dealing is a zero-sum game with a very low certainty of punishment and potentially disproportionate severity of sanctions, so there is a good reason to believe that if there are indeed the righteous insiders they will likely get away with their good deeds in the same way as the disreputable insiders.

2.1.3. Price informativeness

Insider dealing can be economically efficient by improving price informativeness.[71] Should this be unambiguously correct, then the argument that everyone is a potential victim will fall apart. According to this price-informativeness argument, insider dealing drives stock's prices in the right direction thereby facilitating price discovery, which is one of the functions of financial markets.[72] Price discovery means that transactions between buyers and sellers of financial instruments in a financial market determine the price of the traded asset.[73] It is further assumed that uninformed traders can pick up on these insiders' trades, thereby cancelling out

[70] S Martin, 'The Kaldor-Hicks potential compensation principle and the constant marginal utility of income' (2019) 55 Review of Industrial Organisation 493; J R Hicks, 'The foundations of welfare economics' (1939) 49 Economic Journal 696

[71] Manne (n 60)

[72] R J Gilson and R H Kraakman, ‘The mechanisms of market efficiency’, (1984) 70 Vanderbilt Law Review 549, 572-575; L Meulbroek, ‘An empirical analysis of illegal insider trading’, (1992) 47 Journal of Finance 1661; J Lin and M S Rozeff, ‘The speed of adjustment of prices to private information: empirical tests’, (1995) 18 Journal of Financial Research 14. The other two functions are liquidity and reduction of transaction costs discussed in the next section, see R E Bailey, *The economics of financial markets*, (CUP, 2005)

[73] DeFond and others (n 8)

any negative impact that insider dealing might have on social wellbeing.[74] But it is unlikely that an average, not to mention of below than average investor is sophisticated enough to make out and consistently follow the insiders' expectations in the displayed prices even if they are moving towards the real value of the stock in question.[75]

Even sophisticated investors can fall into a trap of believing that they are emulating insiders, which in fact is just noise, [76] or market manipulative practices.[77] Noise traders as opposed to market manipulators are of course not criminal, they trade on fallacious optimism that they are in possession of specific information about the future price of a risky asset.[78] Uninformed market participants can follow and act on noise thinking that it would give them an edge.[79] Subsequently, noise can attract investors erroneously believing that the prices are flowing in the right direction.[80] In contrast, insiders profit on the assumptions being made about the distribution of uncertainty and confine themselves to a specific class of equilibria.[81] Insiders can conceal their trades in a Wiener motion of prices, emanating from these noise trades.[82] Here information asymmetries are intentionally diffused through the dealings, e.g., non-timely

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[74] M S Rozeff and M Zaman, 'Market efficiency and insider trading: new evidence', (1988) 61 Journal of Business 25

[75] T E Copeland and D Galai, 'Information effects on the bid-ask spread' (1983) 38 Journal of Finance 1457

[76] Noise traders trade on fallacious optimism that they are in possession of specific information about the future price of any given financial instrument, F Black, 'Noise', (1986) 41 Journal of Finance 529

[77] Seyhun (n 4)

[78] J B DeLong, A Shleifer, L H Summers, and R J Waldmann, 'Noise Trader Risk in Financial Markets', (1990) 98 Journal of Political Economy 703, 706, they may get their pseudo-signals from technical analysts, stockbrokers and so on and irrationally believe that these signals carry information

[79] Ibid, 704, see also D Kahneman and A Tversky, 'Prospect Theory: An Analysis of Decision under Risk', (1979) 31 Econometrica 49

[80] DeLong and others (n 78) 704; S J Grossman and J E Stiglitz, 'On the Impossibility of Informationally Efficient Markets', (1980) 70 the American Economic Review 393

[81] J C Rochet and J L Vila, 'Insider Trading and Market Manipulations Existence and Uniqueness of Equilibrium', (1991) WP 3318-91-EFA

[82] Professor A S Kyle in his work 'Continuous Auctions and Insider Trading', (1985) 53 Econometrica 1315; used a neutral-risk insider camouflaging his dealings in a continuous auction equilibrium. The Wiener process is also commonly referred to as a Brownian process, which is a stochastic process

disclosure of price sensitive inside information of illegal insiders' trades.[83] This situation portrays a completely different reality. The pricing mechanism still internalises the gradually injected information, it is probably moving prices into the right direction,[84] and permanent inequality of information between market participants still exists,[85] but now this mechanism is under sway of informed traders.[86] It should be made clear that a transmission of information hinges on an order flow, which in its turn rests on insiders' strategies, if they trade slowly, prices reflect this information slowly and vice versa.[87]

Information disadvantages caused by insider dealing will not therefore be overcome by the vast majority of investors.[88] Sooner rather than later, those investors will realise that the market is rigged in favour of insiders,[89] and their confidence will potentially sink.[90] Thus, if

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[83] It applies not only to insider dealing, but as other forms of market abuse also normally capitalise on these information asymmetries too. As it will be seen from the discussion on algorithmic trading (especially high-frequency trading), there are numerous market abuse practices (e.g. layering) allowing offenders to earn abnormal profits

[84] H Leland, 'Insider trading: should it be prohibited?', (1992) 100 Journal of Political Economy 859

[85] Manne (n 60)

[86] The original word used in this article is market manipulation, but for the purposes of this analysis insider dealing and market manipulation are interchangeable, I Goldstein and A Guembel, 'Manipulation and the Allocational Role of Prices', (2008) 75 Review of Economic Studies 133. Their similarity can be observed in the cases of short selling. E Boehmer, C Jones and X Zhang, 'Which Shorts are informed?' (2008) 63 Journal of Finance 491, 524–25; G Durston, 'Muddying the waters: when does short selling become market manipulation?', (2020) 108 Journal of Financial Crime 1369; S E Christophe, M G Ferri and J Angel, 'Short-Selling Prior to Earnings Announcements' (2005) 59 Journal of Finance 1845, earnings announcements of 913 NASDAQ-listed firms in the five days prior to these announcements are examined, and they show that abnormal amounts of short-selling were concomitant to post-announcements stock returns

[87] C W Holden, and A Subrahmanyan, 'Long-Lived Private Information and Imperfect Competition', (1990) 47 Journal of Finance 247

[88] Of course not every investor would realise it, but if large investors start moving away then others will follow suit, V Brudney, 'Insiders, outsiders, and informational advantages under the Federal Securities Laws' (1979) 93 Harvard Law Review 322

[89] Uninformed investors become aware of the presence of informed traders, but they find it costly to pin down these instances, see C Bettis, D Vickrey, and D Vickrey, 'Mimickers of Corporate Insiders Who Make Large Volume Trades', (1997) 53 Financial Analysis Journal 57

[90] L Ausubel, 'Insider Trading in a Rational Expectations Economy', (1990) 80 American Economic Review 1022

investors are not protected, they would not invest, inasmuch as they would anticipate that informed traders will take advantage of them, and *ipso facto* it will decrease investments.[91] Regulations aim to minimise the trading losses of those dealing for exogenous reasons, meaning that their trading is influenced by stochastic flows without knowing private information.[92]

2.2. Financial markets liquidity

There is a risk that as investors come to know that the financial market is brimful of insiders they will move away making this market less liquid.[93] Leland shows that although insider dealing can under certain situations improve market efficiency, i.e., price informativeness, but insider dealing can inflict damage on liquidity traders.[94] On the other hand, Cao and others, in their study on lock-in initial public offering agreements show that insider trades changed trading volume and share price, but they did not affect spreads or liquidity.[95] In this connection, Khan and others, in their analysis of NASDAQ-100 stocks show that market makers are not always capable of discerning insider trades, but as time wears on the market makers can retrospectively identify insider trades and increase the bid-ask spread in future to recover past

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[91] Ibid, M Manove, 'The harm from insider trading and informed speculation' (1989) 104 The Quarterly Journal of Economics 823

[92] Seyhun (n 4) 191, 210

[93] U Bhattacharya and M Spiegel, ‘Insiders, Outsiders, and Market Breakdowns’, (1991) 4 The Review of Financial Studies 255; Y Amihud and H Mendelson, ‘A new approach to the regulation of trading across securities markets’ (1996) 71 New York University Law Review 1411; I Ayres and J Bankman, ‘Substitutes for insider trading’, (2001) 52 Stanford Law Review 235. Liquidity encompasses such transactional characteristics as tightness, depth and resilience, where tightness is the cost of turning around a position over a short period of time and depth is the size of an order flow innovation required to change prices a given amount, and resilience is the speed with which prices recover from a random, uninformative shock, Kyle (n 68), 1316

[94] Leland (n 84)

[95] For example, in C Cao, L C Field and G Hanka, ‘Does insider trading impair market liquidity? Evidence from IPO Lockup expirations’, (2004) 39 Journal of financial and quantitative analysis 25

and countervail future losses.[96] This is what called the adverse selection problem, when a market maker increases a bid-ask price thereby increasing transaction costs,[97] which is especially relevant to quote-driven markets.[98]

Insiders profit from information asymmetries,[99] and asymmetric information increase trading costs.[100] This is corroborated in Cheng and others, who demonstrate that spread widens and depth falls on insider dealing days as compared to non-insider dealing days.[101] Moreover, Posylnaya and others, show that the cost of insider dealing is more severe for SMEs, firms characterised by greater information asymmetry.[102] So, if an insider with perfect information deals in this inside information continuously over an *n*-period of time then the market maker will balance out his losses by ratcheting up the bid-ask spread.[103] The market maker will increase this spread continuously for as long as the insider is trading at the expense of uninformed traders.[104]

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96 W A Khan, H K Baker, M Chaudhry and S K Maheshwari, 'The impact of insider trading in the NASDAQ Market', (2005) 21 the Journal of Applied Business Research 11

97 P Collin-Dufresne and V Fos, 'Do prices reveal the presence of informed trading?' (2015) 70 Journal of Finance 1555, K R Ahern, 'Information networks: evidence from illegal insider trading tips' (2020) 125 Journal of Financial Economics 26, M Kacperczyk and E Pagnotta, 'Chasing private information', (2019) 32 Review of Financial Studies 4997

98 M King, A Roell, J Kay, and C Wyplosz, 'Insider trading' (1988) 3 Economic Policy 163, 168. Transaction costs are classified into costs of search and information, costs of contracting and monitoring, and costs of incentive problems between buyers and sellers of financial assets. Bailey (n 58)

99 Kyle (n 82) see also Grossman and Stiglitz (n 80) 401

100 L K Meulbroek, 'An empirical analysis of illegal insider trading' (1992) 47 The Journal of Finance 1661

101 L Cheng, M Firth, T Y Leung and O Rui, 'The effects of insider trading on liquidity', (2006) 14 Pacific-Basin Finance Journal 467. This result suggests that increased share trading by insiders impairs liquidity

102 V Posylnaya, B N Cline, and J R Aaron, 'The liquidity impact of insider trading on small and medium sized enterprises' (2019) 29 Journal of Small Business Strategy 72

103 The bid-ask spread is the difference in price between the highest price that a buyer is willing to pay for an asset and the lowest price for which a seller is willing to sell it. This spread is determined by market makers on quote-drive markets, on order-driven markets bid-ask spread is determined by the investors wishing to acquire or dispose a security

104 J H Shin, 'The Optimal Regulation of Insider Trading', (1996) 5 Journal of Financial Intermediation 49 Article No. 0004, 52. Although, it is possible that liquidity can be stable (or even increase) whilst insiders trade, if the

It is also suggested that liquidity issues are more pronounced in options markets.[105] Market makers in options markets suffer twice as much losses as market makers on equity markets, because in the latter markets the market makers profit from bid-ask spreads,[106] but on the options markets, the market makers write options for a premium to be executed at a future date.[107]

2.3. Agent-principal problem

Professor Manne suggests that insider dealing act as a means of compensation for managers.[108] Inside information can be price-sensitive,[109] but it can also be not price-sensitive.[110] Permitting

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number of noise trades is big. H R Stoll, ‘Inferring the Components of the Bid-Ask Spread: Theory and Empirical Tests’, (1989) 44 Journal of Finance 115. However, the market liquidity can increase whilst the insiders trade, because of noise traders trading on the basis of false information see B Cornell and E R Sirri, ‘The Reaction of Investors and Stock Prices to Insider Trading’, (1992) 47 Journal of Finance 1031, 1054; F Black, ‘Towards a Fully Automated Exchange, Part I’ (1971) 27 Financial Analysis Journal 27, 29-34

[105] S Dolgopolov, ‘Risks and hedges of providing liquidity in complex securities: the impact of insider trading on options market makers’, (2010) 15 Fordham Journal of Corporate and Financial Law 387, 402; H C Huang and P Tung, ‘The effects of liquidity trading on insider trade timing when an underlying option is present’, (2018) 44 Managerial Finance 1250. The above findings have important implications for market regulators. Since the insider’s propensity to buy before announcements in stocks without options listed is larger than in stocks with traded options and the relationship is stronger for unscheduled announcements than for scheduled ones, the efforts of regulators should focus on monitoring insider trading in stocks without options listed prior to unscheduled announcements

[106] Market makers purchase securities at bid price with expectation of earning revenue from selling them at ask price, Copeland and Galai (n 75). S Dolgopolov, 'Insider trading, informed trading, and market making liquidity of securities markets in the zero-sum game' (2012) 3 William and Mary Business 1

[107] Ibid

[108] Manne (n 60)

[109] I Bostan and G Mujtaba Mian, 'Do insiders trade on innovation?' (2023) 19 Journal of Contemporary Accounting and Economics 100350, in their study of insiders' purchases and corresponding sales over two successive years can act as a strong predictor of a firm's patent applications

[110] R T Masson and A Madhavan, 'Insider Trading and the Value of the Firm' (1991) 39 The Journal of Industrial Economics 333

insiders to deal in inside information can produce several serious problems as managers, or whoever is in possession of inside information can use this information; however, they wish.[111] Insiders can be become more aggressive risk takers,[112] incentives are created to improperly disseminate corporate information,[113] or tamper with corporate disclosures until insiders occupy a position in the financial instruments.[114] The last two risks imply that stock prices become less informative.[115] All of that could lead to insiders becoming indifferent as to whether their firms' value is increasing or decreasing.[116] What it means is that insiders can as increase as lower long-term firm value as they can effectively profit from both bad and good news.[117] Consequently, insiders may have incentives to adopt non-value-maximising strategies[118] causing shareholders to suffer losses.[119]

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[111] R A Schotland 'Unsafe at any price: a reply to Manne, Insider Trading and the stock market' (1967) 53 Virginia Law Review 1425, 1451; S Levmore 'Securities and secrets: insider trading and the law of contracts' (1982) 68 Virginia Law Review, 117, 149; R T Miller, 'Insider trading and the public enforcement of private prohibitions some complications in enforcing simple rules for a complex world' (2021) University of Iowa Legal Studies Research Paper 2021-14

[112] F H Easterbrook 'Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information' (1981) 1981 Supreme Court Review 309; R T Masson and A Madhavan, 'Insider trading and the value of the firm', (1991) 39 Journal of Industrial Economics 333, 335

[113] Ibid. Also, R Posner, *Economic analysis of law*, (2nd, Little Brown, 1977), 308

[114] S Levmore, 'In Defence of the Regulation of Insider Trading' (1988) 11 Harvard Journal of Law and Public Policy 101, 103

[115] R Benabou and G Laroque, 'Using privileged information to manipulate markets: insiders, gurus, and credibility' (1992) 107 Quarterly Journal of Economics 921

[116] M Mendelson, 'The Economics Board of Insider Trading Reconsidered', (1969) 117 University of Pennsylvania Law Review 470, 489-90

[117] Padilla (n 29)

[118] Levmore (n 114) 149

[119] Easterbrook (n 112) 312

2.4. Efficient market hypothesis

In order to answer question (b), this thesis will look at the efficient market hypothesis, a theory on the workings of financial markets. The theoretical assumptions and their limitations will be discussed not to denigrate the hypothesis, but to show that financial regulators can over-rely upon certain theoretical models.

2.4.1. Assumptions in brief

In the aftermath of the financial crisis of 2007/09, the last Chairman of the Financial Services Authority, blames the 'unrealistic' assumptions of the efficient market hypothesis for the disaster.[120] One of the primary objectives of the Financial Services Authority (hereinafter the FSA), the predecessor of the FCA, was to protect investors from insider dealing. Therefore, it is astoundingly interesting given that the FSA had accepted these assumptions itself, but later went on to excoriate the model without admitting to having concurred with it. The aim of this Section is thus neither to pick holes in the efficient market hypothesis (hereinafter the EMH), nor to stand up for the EMH, but attempt to comprehend why a financial regulator can over-rely on a single theoretical approach and disregard other alternative viewpoints thereby jeopardising the effectiveness of regulations. The other aim of this section is to try to understand whether according to the EMH insider dealing distorts prices or incorporates actual information before anyone trades.[121] Because if the EMH does not claim that the latter is always true, then the blind acceptance of the EMH by the Regulator(s) has been a blunder.

A little specialised language is required in outlining the idea behind the EMH. So, the EMH originates in the theory of random walk of prices, which was subsequently developed to represent Wiener motion of prices following the Markov process on the assumptions of a fair

[120] FSA, 'The Turner Review a regulatory response to the global banking crisis' (2009), para 1.4

[121] Meulbroek (n 100) 1662

game where prices follow a martingale.[122] The EMH therefore postulates that an efficient market is such a market where the current price of a stock reflects all available information.[123] Stocks' prices fluctuate up or down independently from any previous state and returns on those stocks follow a normal distribution.[124] Yesterdays' prices of a stock will therefore tell an investor nothing about a potential future price, except that this price reflects all available information in relation to that stock and that the best expectation of a future return is today's return,[125] because flows of information are incorporated into prices unimpededly by actions of rational utility-maximisers.[126] So, if an investor looks up at the consolidated tape, they will without incurring any cost observe all information through the prices.[127] Malkiel famously describes this assumption in the following description that even '[a] blind-folded chimpanzee

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[122] It means that price equals its fundamental value, P A Samuelson, ‘Proof that properly anticipated prices fluctuate randomly’ (1965) 6 Industrial Management Review 41; J F Muth, ‘Rational expectations and the theory of price movements’, (1961) 29 Econometrica 315

[123] E F Fama, 'Efficient capital markets: a review of theory and empirical work' (1970) 25 Journal of Finance 383, 414, 386. E Fama, ‘Efficient Capital Markets: II’ (1991) 46 Journal of Finance 1575; J F Jaffe, ‘Special Information and Insider trading’, (1974) 47 the Journal of Business 410. For a general and less technical summary on the EMH see A G Titan, ‘The efficient market hypothesis: review of specialised literature and empirical research’, (2015) 32 Procedia Economics and Finance 442; J B Baesel and G R Stein, ‘The value of information: Inferences from the profitability of insider trading’, (1979) 14 The Journal of Financial and Quantitative Analysis 553; J H Lorie and V Niederhoffer, ‘Predictive and Statistical Properties of Insider Trading’, (1968) 11 Journal of Law and Economics 35; J E Finnerty, ‘Insiders and market efficiency’, (1976) XXXI Journal of Finance 1141; L A Jeng, A Metrick and R Zeckhauser, ‘Estimating the returns to insider trading: a performance-evaluation perspective’, (2003) 85 The Review of Economics and Statistics 453

[124] A normal distribution or a Gaussian distribution implies a very small probability of extreme events as it is normally within three standard deviations from the mean. The central limit theorem states that after numerous transactions per day, or as in this example tosses of the coin, these prices will form a normal distributions, E F Fama, 'The Behavior of Stock Market Prices' (1965) 38 Journal of Business 105. Louis Bachelier, a French mathematician was first who suggested this idea of random walk of prices. Basically, according to him prices move in the same way as tossing a coin, L Bachelier 'Théorie de la Spéculation' (1900) 3 Annales scientifiques de l’École Normale Supérieure 21

[125] Ibid

[126] J Crotty, ‘Structural causes of the global financial crisis: a critical assessment of ‘the new financial architecture’’ (2009) 33 Cambridge Journal of Economics 563

[127] Fama (n 123), 387

throwing darts at the Wall Street Journal could select a portfolio that would be as well as the experts'.[128] Any abnormal returns are down to chance.[129]

There are three forms of market efficiency, strong, semi-strong, and weak.[130] Strong form does not recognise insider dealing, as it surmises that all information including private information is incorporated into stocks' prices.[131] The semi-strong form of efficiency states that all publicly available information is reflected in prices, and the weak form of efficiency postulates that only current and past rates of return are observable in prices.[132] Myron Scholes in his PhD shows that there exist private information which are not reflected in prices.[133] This was one of the first findings refuting the strong form of efficiency, but supporting the semi-strong form of market efficiency.[134] On this note, this section will now turn to the limitations of the EMH with respect to insider dealing, and why this model has exerted so much influence over the financial regulatory process.

2.4.2. Limitations of the model and minimal intervention

None of the aforementioned assumptions are meant to be perfectly reflecting reality, nor they have been unanimously accepted within the economics scholarships.[135] As it was pointed out

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[128] B G Malkiel, *A random walk down Wall Street*, (W.W. Norton & Company, NY, 1985), in preface

[129] Ibid

[130] Fama (n 123)

[131] These studies for example support the strong form efficiency of financial markets, H S Kerr, 'The Battle of Insider Trading vs. Market Efficiency' (1980) Journal of Portfolio Management 47 (Summer); J Lin and J S Howe, 'Insider Trading in the OTC Market' (1990) 55 Journal of Finance 1273; C Holderness and D P Sheehan, 'Raiders or Saviours? The Evidence on Six Controversial Investors' (1985) 14 Journal of Financial Economics 555

[132] Fama (n 123)

[133] M Scholes, 'A Test of the Competitive Hypothesis: The Market for New Issues and Secondary Offerings' (1969) Unpublished PH.D. thesis, Graduate School of Business, University of Chicago

[134] This early study by V Niederhoffer and M F M Osborne, 'Market Making and Reversal on the Stock Exchange' (1966) 61 Journal of the American Statistical Association 897, also shows that market is inefficient in terms of the strong form

[135] Fama (n 123) 411, H Minsky, 'Stabilising an Unstable Economy' (1986) Economics Department, Washington University; or R J Shiller, 'From efficient markets theory to behavioural finance', (2003) Cowles foundation paper

earlier, the EMH expects prices to be normally distributed, so the model somewhat ignores fat tails and jumps in prices.[136] Or, the assumption that every actor in a financial market is in possession of (near) perfect information is rather absurd. Stiglitz confounds this assumption by adding a modicum of information imperfection which could destabilise the EMH equilibrium.[137] Insiders influence prices, noise traders influence prices, but so do lawful trading strategies of large institutional investors.[138] The difference between the former and the two latter is that the insider knowing the real underlying probability distribution generating a future price can occupy a profitable position beforehand, meanwhile the rest of the market are either invest in acquiring information or simply rely on displayed prices.[139] Thus, if stocks' prices reflected all information, there would be no informational asymmetries,[140] and no incentives to acquire information as there would be no compensation.[141] The EMH is therefore just an approximation to or an expectation of certain classes of events or circumstances.[142]

No. 1055; and an interesting discussion conducted by CBR, Are Markets Efficient? Between E Fama and R Thaler, the latter is a financial behaviouralist criticises the EMH, available at https://review.chicagobooth.edu/economics/2016/video/are-markets-efficient, accessed 10 July 2023

[136] Benoit Mandelbrot on efficient markets FT.com 30 September 2009, he was critical of the EMH. In a normal distribution 99.7 per cent of data observed is found in three standard deviations, so anything lying beyond three standard deviations is considered very improbable

[137] J E Stiglitz and A Weiss, 'Credit rationing in markets with imperfect information' (1981) 71 The American Economic Review 393; J E Stiglitz *Globalisation and its Discontents*, (W.W. Norton & Co, 2002)

[138] JJ Laffont and E S Maskin, 'The efficient market hypothesis and insider trading on the stock market' (1990) 98 Journal of Political Economy 70

[139] Turner Review (n 120); R E Kihlstrom and L J Mirman, 'Information and market equilibrium', (1975) 6 The Bell Journal of Economics 357, in their model on a futures market argue that future prices can be inferred if and only if a trader can pin down the insider's expectations in market prices

[140] P Milgrom and N Stokey, 'Information, Trade and Common Knowledge', (1980) 26 Journal of Economic Theory 17

[141] It is called the Grossman-Stiglitz paradox, Grossman and Stiglitz (n 80), 405

[142] The episode of The Big Question with E Fama and R Thaler conducted by Chicago Booth Review of 30 June 2016, in which E Fama in his response to R Thaler's remark on 'One is whether you can beat the market. The other is whether prices are correct', says 'It is a model, so it is not completely true. No models are completely true. They are approximations to the world. The question is: 'For what purposes are they good approximations?' As far as I am concerned. They are good approximations for almost every purpose...It is a model – it is not entirely always true, but it is a good working model for most practical uses'

The models used to test the assumptions of the EMH have been criticised for their simplicity, straightforwardness, and not tailored to real-world fundamentals.[143] Insider dealing is about making a profit, and it is profitable,[144] meaning that insiders can beat the market regularly and continuously, and not by chance. Prices do not always follow random walk patterns, and a future price can be conditional on the past price pointing to profit opportunities which insiders can avail themselves of dealing in.[145]

The importance of the EMH in the context of this thesis is that it comes from the neoliberal school of economics known for its position on deregulation of financial markets, i.e., there should be minimal to no regulation and intervention by governments' bodies.[146] Only in cases of severe market failures such intervention is justified.[147] In all other situations it is believed that rational utility maximisers as well as competing firms are able to settle any dispute

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143 P Krugman, 'How did economists get it so wrong' (2009) The New York Times Magazine, September 2, available at https://www.nytimes.com/2009/09/06/magazine/06Economic-t.html, accessed 24 July 2023

144 There is a large body of literature empirically showing the profitability of insider dealing, for instance, E Kandel and N Pearson 'Differential Interpretation of Public Signals and Trade in Speculative Markets' (1995) 103 Journal of Political Economy 831 observe abnormal movements in returns and volumes on the days immediately preceding and following earnings announcements. A J Keown and J M Pinkerton 'Merger announcement and insider trading activity: an empirical investigation' (1981) 36 Journal of Finance; N Linciano 'The Effectiveness of Insider Trading Regulation in Italy. Evidence from Stock-Price Run-Ups Around Announcements of Corporate Control Transactions' (2003) 16 European Journal of Law and Economics 199; J Lakonishok and I Lee, 'Are insider trades informative' (2001) 14 Review of Financial Studies 79, show that price run-ups prior takeover announcement pointing to potential profits. Many other studies on the profitability of insider dealing for instance, T Miles, and J Hamshire, 'Plea by wife saves a City cheat from jail', (1987) Daily Mail (London, England) July 2, Issue 28309. It should be noted that, insider dealing is about making a profit, but it does not mean that insiders are bound to generate any profit. There was a case of Collier, who in the mid-1980s while in a position of head of securities at Morgan Grenfell had dealt in inside information but did not generate any profits, instead it knocked him back an additional loss of £10,000 on his first deal. He was sentenced to a 12-month suspended sentence and fined £25,000

145 S F LeRoy, 'Efficient capital markets and martingales' (1989) 27 Journal of Economic Literature 1583; A M Whittaker, 'The Role of Competition in Financial Services Regulation', Speech to the Regulatory Policy Institute, 27 April 2001

146 K J Arrow 'The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation', in R H Haveman, and J Margolis (eds), *Public Expenditure and Policy Analysis*, (Rand MacNally College Publishing Company, 1980)

147 Davies (n 48), 2; M Friedman, *Capitalism and freedom*, (40th edn, University of Chicago Press, 2002)

between each other more efficiently.[148] Having accepted the EMH as the fundamental model defining the operations of financial markets while disregarding this model's shortcomings in relation to insider dealing shows that financial regulators can exhibit tunnel vision leading to market as well as regulatory failures.

This challenge is not growing out of the EMH's assumptions, or any other neoliberal economics' models,[149] but the way how (former) financial regulators regard particular theoretical assumptions and models predicated upon them as something infallible, correct, thereby turning a blind eye to the very fact that such theories can be repugnant to the purpose of insider dealing regulations. Any potential answer to this question will bound to contain numerous strands, but this thesis concurs with Benoit Mandelbrot, who once aptly opined that accepting the assumptions of the EMH and disregarding the associated risks could simply be put down to a promised capital on which the economies could prosper for a while.[150] Buffet and Munger's view in relation to that almost ubiquitous embrace of the EMH by academia as well as states' policies was not churlish or gloating, but possibly correct in suggesting that due to all that time and efforts being dedicated to devising, testing, and spreading about the model(s) it is difficult to back off after having got 'an enormous amount of yourself and ego'.[151]

2.5. Concluding remarks

This chapter attempted to answer questions (a) and (b). It was argued that insider dealing regulations are justified on the basis of at least three arguments, namely, the confidence argument, the liquidity argument, and the principal-agent problem argument. However, these justifications are not universally accepted pointing to a complicated nature of insider dealing.

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[148] P N Hablutzel, 'British Banks' Role in U.K. Capital Markets since the Big Bang', (1992) 68 Chicago-Kent Law Review 365; R Coase 'The problem of social cost' (1960) 3 Journal of Law and Economics 1; G J Stigler 'The theory of economic regulation', (1971) 2 Bell Journal of Economics 3

[149] See for example, the capital asset pricing model, or shortly CAPM

[150] Benoit Mandelbrot on efficient markets FT.com 30 September 2009, he was critical of the EMH. Paul Krugman similarly labels these assumptions lucrative, Krugman (n 143)

[151] Warren Buffett and Charlie Munger discuss the efficient market theory and its popularity at universities. From the 1998 Berkshire Hathaway annual meeting, Morning session, 4 May 1998

This thesis nevertheless accepts the overarching social welfare argument, that is, the interests of the larger category of investors ought to be protected against the interests of the smaller category of informed investors.[152] This social-welfare argument is persuasive and justifies the prohibition of insider dealing, in that financial regulations in this sense are a public good, which can be consumed by everyone,[153] but insider dealing undermines this purpose. However, the idea of social wellbeing, or the greater good can be obscure,[154] therefore this holds its view on the undesirability of insider dealing on the possibility of it creating imperfect competition, misallocation of resources, and wealth leading to reduced social wellbeing.[155]

Arguably, the only way for insider dealing to be legalised is to decipher the nature of insider dealing by determining the following three considerations, how should gains and losses be gauged when informed traders benefit from the majority's losses, how should the investors' estimation of the values of the obtained benefits be scaled?[156] which both lead to how is precise any given quantified amount of illegal gains from insider dealing? This fundamental quantification challenge is not eradicable in the sense that the nature of insider dealing of being economically efficient, or legal in certain circumstances complicates the enforcement of insider dealing regulations thereby potentially undermining effectiveness.[157]

The second takeaway from this Chapter is that former regulators over-relied upon the EMH, which assumptions to some extent are at odds with the purpose of insider dealing regulations. Krugman once penned that financial regulators 'put the capital development of the

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[152] HM Treasury, *The Public Value Framework: with supplementary guidance*, March 2019; FCA, Our Mission 2017*, How we regulate financial services*, 2017

[153] A Bailey, 'The future of financial conduct regulation', CEO of the FCA, Speech at Bloomberg, London, 23 April 2019

[154] T M Jones and W Felps 'Stakeholder happiness enhancement: A neo-utilitarian objective for the modern corporation' (2013) 23 Business Ethics Quarterly 349, 373

[155] S Peltzman, 'Toward a more general theory of regulation' (1976) 19 The Journal of Law and Economics 211, 213; D Haddock and J R Macey, 'Regulation on demand: a private interest model, with an application to insider trading regulation' (1987) 30 The Journal of Law and Economics 311, 312; M P Dooley, 'Enforcement of insider trading regulations' (1980) 66 Virginia Law Review 1, 48

[156] I am influenced by J C Smart and B Williams, *Utilitarianism – For and against* (edn, CUP 1973) and M N Rothbard, *The Logic of Action One: Method, Money, and the Austrian School,* (edn, Edward Elgar, 1997)

[157] This discussion will be carried out in chapter four

nation in the hands of what Keynes had called a “casino'.[158] Perhaps, it just happened that the enactment of insider dealing regulations in the UK coincided with the upswing in neoliberal economics pushing the idea of deregulation. As a consequence, the absence of robust evidence creates somewhat ambivalent feelings about insider dealing which has been subsumed by the wider implementation of financial regulations moulded in accordance with the EMH and other pertinent assumptions.[159] Financial regulators can therefore be influenced by certain theoretical assumptions or models which can lead to a regulatory failure. This is inevitable if a financial regulator glosses over various theoretical shortcomings of such theories that affect enforcement hence deterrence, or which are in conflict with the statutory objectives. Brushing aside alternative views which can rectify and enhance the understanding of reality is therefore a serious mistake. Any model prescribing or describing the operations of financial markets are just approximations attempting to strengthen the existing knowledge of reality or engineer a benchmark against which the real world scenarios are compared. Investor protection in any model should remain constant. It is therefore possible that, the FCA, perhaps, unbeknownst to itself has been adhering to a faulty system of operations not capable of effectively delivering deterrence through enforcement. But such challenges can be rectified.

[158] Krugman (n 143)

[159] A Shleifer, ‘Understanding regulation’, (2005) 11 European Financial Management 439; R W Crandall, ‘Deregulation: the U.S. Experience’, (1983) Bd 139 H.3, Journal of Institutional and Theoretical Economics 419; and C Winston, ‘U.S. Industry adjustment to economic deregulation’ (1998) 12 Journal of Economic Perspectives 89

CHAPTER THREE

Challenges and solutions associated with regulatory frameworks and approaches to insider dealing regulations

This chapter will aim to answer question (c) by focusing on the historical developments in insider dealing regulations within a period from the 1940s until the introduction of the Financial Conduct Authority on the 1st of April 2013. It should be noted that, insider dealing, or rather dealing in non-public price-sensitive information dates as far back as the 19th century. For example, before the 1870 Franco-Prussian war, British Government stocks plummeted. Former UK Prime Minister, Gladstone having learnt that France would respect the neutrality of Belgium, and that Britain would not be embroiled in the war, bought for his own account consols for £2,500 at the temporarily depressed price of 90p.[160] Of course, the Prime Minister did not think he was doing something improper. The reason for locking in this time period is twofold. First, although insider dealing has much a longer history, it was not until the seminal case of *Percival v Wright,*[161] in which the question about the wrongfulness of insider dealing came under scrutiny in the 1940s. Second, in response to the regulatory failures during the global financial crisis of 2007/09, the Financial Services Authority was replaced by the Financial Conduct Authority ushering in new rules, revised, and amended legislation and legal powers. Therefore, it is prudent to divide this examination of the challenges to enforcement according to two periods, namely, prior to the introduction of the FCA in 2013, which will be covered in this chapter, and after the introduction of the FCA, which will be carried out in chapter four. For this reason, lest be tautological, some of the discussion will be omitted and instead will be developed later.

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[160] R Jenkins, *Gladstone*, (Random House Publishing, 2002)

[161] [1902] 2 Ch 401

3.1. Developments prior to criminalisation: from *Percival v Wright* to the dissolution of Financial Services Authority

The economic depression of the early 1930s together with the Second World War forced the UK to transform from a creditor to a debtor nation.[162] These transformation had had a bearing on the corporate world where the ever-increasing number of shareholders, the emergence of new holdings and private companies and other factors were the reasons for reforming the Companies Act 1929.[163] Addressing these problems was assigned to a special Committee chaired by Lord Cohen.[164] The scope of its inquiry was immense. The Report is full of recommendations touching upon private companies, mortgages and charges, relations between holding and subsidiary companies, financial relations between companies and directors, nominee shareholdings, investigation of affairs of companies, winding-ups, and shareholders' control.[165]

The Committee also commented on the rights of shareholders through re-evaluating the principle laid down in the decision of the landmark case of *Percival v Wright.*[166] This principle conveys the concept that the directors of a company do not owe a fiduciary duty to the individual shareholders, but to the company itself.[167] In other words, the director is a trustee of

[162] Report of the Cohen Committee on Company Law Amendment (1947) 73 Journal of the Institute of Actuaries (1886-1994) 20, per L G Whyte

[163] Ibid

[164] The Report of the Committee on Company Law Amendment (Cohen Report 1945) Cmd 6659, available at https://www.takeovers.gov.au/content/Resources/other_resources/Cohen_Committee.aspx, accessed 21 January 2021. The Companies Act 1929 was needed reforming after the Great Depression of the early 1930s drastically changed the perceptions on companies and their directors, for a general discussion see P Bircher, 'From the Companies Act of 1929 to the Companies Act of 1948: a study of change in the Law and Practice of Accounting', (1989) a thesis submitted for the University of London PhD degree, 107

[165] For more detailed information see, A E Davies, 'Shareholders' charter: the Cohen Committee's Report', (1946) 17 The Political Quarterly 137, or A Johnston, B Segrestin and A Hatchuel, 'From balanced enterprise to hostile takeover: how the law forgot about management', (2019) 39 Legal Studies 75

[166] *Percival v Wright* (n 161)

[167] Chapter 2 of the Companies Act 2006 enshrines directors' duties

the company,[168] and acts as an agent in transactions which he enters on behalf of the company,[169] but he is not a trustee for individual shareholders.[170] The thrust behind the principle is that, if directors were under such a duty, then they would be deprived of an opportunity to acquire or dispose of securities without having to disclose relevant information to shareholders beforehand, potentially resulting in premature disclosure.[171] What it meant was that the directors could deal in inside information at the time when the shareholders were unaware of such transactions. In this connection, paragraph 86 of the Report concludes the following,

> '…[E]ven if the legislation is not entirely successful in suppressing improper transactions, a high standard of conduct should be maintained, and it should be generally realised that a speculative profit made as a result of special knowledge not available to the general body of shareholders in a company is improperly made…'.

Paragraph 87 of the Report follows through with a solution to the problem by indicating that there should be a deterrent effect influencing the decision-making process of directors,

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[168] Even though it is not a standard trustee relationship, directors like trustees, bear the onus of holding the funds and/or assets of their company(s), in *Re Lands Allotment Co* [1894] 1 Ch 616

[169] *Great Eastern Railway Company v Turner* (1872) L.R. 8 Ch. 149; and *Aberdeen Railway Co v Blaikie Bros* (1854) UKHL 1 Paterson 394. See L S Sealy, 'The Director as Trustee', (1967) 25 Cambridge Law Journal 83, and L C B Gower, 'The English Private Company' (1953) 18 Law and Contemporary Problems 535

[170] There are some exceptions to this rule, the most frequent is the 'fraud on the minority' exception entitles a minority for a derivative action, which refers to an abuse of power, for general discussion see D Kershaw, 'The Rule in *Foss v Harbottle* is Dead; Long Live the Rule in *Foss v Harbottle'* (2015) 3 Journal of Business Law 274. In the case *Regal (Hastings) Ltd. v. Gulliver* [1942] 1 A11 E.R. 378 it was set out that there should be a duty of directors to account for their profits based on their employment to a company; and section 172(3) of the Company Act 2006 lays down that directors in certain circumstances, such as in a take-over setting, do owe a fiduciary duty to creditors of a company, and must act in the best interests of the latter, see *Gething v Kilner* [1972] 1 W.L.R. 337. Likewise, a fiduciary relationship may exist between directors and shareholders if there are family ties between them, see *Coleman v Myers* [1977] 2 NZLR 225. Further developments can be observed in *Dawson International plc v Coats Patons plc* [1989] BCLC 233, if directors assume some responsibility for their shareholder(s) then they must conduct these responsibilities in good faith, therefore a fiduciary (director) must be responsible what they have taken responsibility for, *Bristol and West Building Society v Mothew* [1998] Ch. 1

[171] *Percival v Wright* (n 161), see also P L R Mitchell, *Director's Duties and Insider Dealing*, (Butterworths, 1982), 110

> '…of itself be a deterrent to improper conduct and the shareholder can, if they think fit, ask for an explanation of transactions disclosed…'.

That is, a shareholder(s) would have a right to question any transaction(s) carried out by the directors afterwards thereby circumventing the *Percival's* principle. Notwithstanding that it was a leap forward in the discourse on insider dealing, there was still a long way to prohibiting insider dealing. The scope of these opinions was locked in the relationships between directors and shareholders thus missing out outside investors of the consideration, and there was not any statutory backing forbidding this practice.[172]

The work of the Committee unfolded in the conditions of self-regulation. Self-regulation was the product of mutual trust between the members of the City of London. As a result, it was believed that there was no justification to impose external supervision to rectify market failures or misunderstandings.[173] However, in the 1950s a new practice of hostile takeovers sprung up discrediting this gentlemanly way of conduct. The hostile takeover involves a bidding company wishing to acquire another company (a target company) but is strongly opposed by the management of that target company. Getting round this unyielding management was possible by acquiring the shareholders' shares hence subsequently acquiring voting rights through which the bidder implements the relevant changes (e.g. removes the obstinate management).[174] To bring this practice under control, in 1959, the Bank of England convened the City Working Party to devise the Notes on Amalgamations of British Businesses.[175] They were non-binding, but it could not detract from the two fundamental takeover principles these Notes set down for protecting the shareholders. Principle III sets out the following,

> 'To enable him [the shareholder] to come to a considered decision, the shareholder should have in suitable form and at the right time all relevant information, and it is the duty of the Board of his company to make every

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[172] It was not put in the Companies Act 1948

[173] B A K Rider and E J Hew, 'The regulation of corporations and securities laws in Britain: the beginning of the real debate', (1977) 19 Malaya Law Review 144

[174] A Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code', (2007) 66 The Cambridge Law Journal 422

[175] No 190916

> effort to ensure that such information is provided and to give him their advice'

This principle was therefore pressing ahead with the establishment of disclosure requirement so that a shareholder can make an informed decision,

> 'Every effort should be made to avoid disturbance in the normal price level of shares until the relevant information has been made available'[176]

There was still no reference made to outside investors, but anyway these Notes were for the most part waved aside by City's participants, and could not salvage the self-regulatory system from falling apart on which Marley commented,

> 'The bitterness and division ran deep. The network of gentility and politeness broke down completely, far from keeping in touch with each other, the opposing banks indulged in personal animosity… the worst aspect of the matter…was that the public had a ring side seat to observe that when it came down to ethics and propriety, the top figures of the City…were at each other's' throats'[177]

There was an urgent need to repair the relationships between the directors and the shareholders calling for a reconsideration and readjustment of the provisions and workings of the Companies Act 1948, and a revision of the Prevention of Fraud (Investments) Act 1958. To do that the Board of Trade set up a Committee chaired by Lord Jenkins to look into these issues.[178] The Report of the Jenkins Committee was voluminous. The report touched upon the formation and powers of companies, classification of companies, duties of directors, ownership and control of companies, reduction of capital and buy-back programmes, and the protection of investors. Similar to the Cohen Committee, the Jenkins Committee paid attention to insider

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[176] Ibid, Principle IV

[177] E Stamp and C Marley, *Accounting Principles and the City Code: the case for reform* (Butterworth & Co, 1970) 8

[178] The Report of the Company Law Committee of the Board of Trade (1962) Cmnd 1749. See also Jenkins Committee on Company Law, (1963) 89 Journal of the Institute of Actuaries (1886-1994) 105, for a brief overview of most prominent recommendations see R R Pennington, 'The Report of the Company Law Committee', (1962) 25 The Modern Law Review 703; or R Roberts, 'Regulatory Responses to the Rise of the Market for Corporate Control in Britain in the 1950s' (1992) 34 Business History 183, 194

dealing, but now from a more general perspective. In paragraph 89 of the Report, the Committee found another fault with the *Percival's* principle that,[179] '

> '…[O]nce a director of a company did owe no fiduciary duty to individual members of the company, then *a fortiori* that none is owed to a person who is not a member'

What it implied was that the scope of insider dealing debate had to be expanded to including outside investors because the law should protect any person without differentiating whether a victim of a director's unethical actions has or has not affiliation to the company(s) concerned.[180] In contrast to the aforementioned considerations, this Report in paragraph 90 took an uncompromising stance on insider dealing,

> 'A director of a company should not deal in options in securities of his company or of the group to which the company belongs. A director who speculates in this way with special inside information is clearly acting improperly…'

This recommendation was later converted into section 25 of the Companies Act 1967 laying down that, directors, their spouses or children are prohibited from dealing on pain of criminal punishment in certain options to buy or sell quoted shares in, or quoted debentures of, the company or associated companies.[181] However, its narrowness could not tackle the problem as its scope fell within the dealings of a director (related persons) and his company(s) thus leaving other unconnected companies out, and other potential insiders were also not brought under the prohibition.

The problem of insider dealing came back from limbo due to several high-profile financial scandals[182] showing up the narrow application of section 25 of the 1967 Act and its inadequacy to suppress insider dealing. This time, in 1972, the Board of Trade entrusted the

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[179] Ibid, para 89

[180] Ibid

[181] On summary conviction, to imprisonment for a term not exceeding three months or to a fine not exceeding £200, or to both; or on conviction on indictment, to imprisonment not exceeding two years or to a fine, or to both

[182] See for a general discussion R Spiegelberg, *The City power without accountability*, (1st edn, Blond and Briggs, 1973)

Justice Committee[183] chaired by Goodhart with the task to assess the problem of insider dealing.[184] It was the JUSTICE Committee's Report which succinctly defined insider dealing, pushed on for criminalisation, and emphasised that the prosecution powers to be given to a government body, the Department for Trade and Industry (the DTI).[185] The vindication was premised on trust and confidence,

> 'Contrary to good business ethics that a man holding a position of trust in a company should use confidential information for his personal benefit'.[186]

Given the narrowness of section 25 of the Act 1967, the Committee suggested bringing practically everyone having access to inside information under regulation.[187]

It should be noted that, in 1968, the companies operating in the City set up the Panel on Takeovers and Mergers (hereinafter the Panel). The idea was that the Panel would hold sway in the area of mergers and acquisitions by administering the City Code on Takeovers and Mergers.[188] In 1973, the Panel and the Exchange issued a Joint Statement in which they agreed that insider dealing was disruptive to the confidence in the capital markets, thus also extending the rationale of insider dealing to protecting every investor and not just shareholders and surmised that criminal liability would deter would-be offenders.[189]

The question of criminalisation was not as much debatable as enforcement of insider dealing regulations. Sir Wilkinson, the then Chairman of the Exchange warned that, the

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[183] JUSTICE is the British Section of the International Commission of Jurists

[184] Report by Justice Society, Insider Trading (1972), London paragraphs 28 and 35. For more on the Report see M Kay, 'The JUSTICE Report on Insider Trading', (1973) 36 The Modern Law Review 185

[185] Ibid, paragraph 35, or with the consent of the DTI

[186] Ibid

[187] Ibid, paragraph 21

[188] The City Working Party was reconvened to draw up this Code, which is a set of rules to be obeyed by all listing companies in the UK in the process of takeovers. For a general discussion see B Hannigan, *Company Law*, (5th edn, Oxford, 2018), and A. Johnston, The City Takeover Code (Oxford, 1980); or B A K Rider, 'Self-Regulation: The British approach to policing conduct in the securities business, with particular reference to the role of the City Panel on Take-overs and Mergers in the regulation of insider trading' (1978) 1 Journal of Comparative Corporate Law and Securities Regulation 319

[189] The Joint statement on (Insider Dealing) Company Law, The Panel and Stock Exchange 3rd February 1973, and the Panel on Take-overs and Mergers, Report on the Year ended 31st March 1973, 9

complicated nature of insider dealing would be very difficult to ascertain stalling prosecutions.[190] Perhaps, in addition to the complexities of insider dealing itself, the *vigilant neutrality* of the Board of Trade in supervising industry was highlighted as far back as in 1928.[191] In fact, the DTI puzzlingly adhered to a philosophy of minimising enquiries as they would do more harm than good from the standpoint of the company and its investors.[192] John Smith, the then Secretary of State for Trade and Industry stressed that, there should be balance between catching criminals and facilitating legitimate business.[193] Although, little was elaborated on as to how proportionately strike this balance, it seems that the Government were more inclined not to inhibit legitimate business.[194]

Therefore, the White Paper in Company Law Reform of 1973, which proposed criminalisation of insider dealing,[195] was met with scepticism, as the Sunday Times wrote, [196]

> '…[A]ll those new provisions on dealings and disclosures will suffer the fates of so much company law in Britain – excellent on paper but not enforced in practice -… lack of effective surveillance monitoring, and enforcement has been the greatest scandal of Company law in the past'

It was evident that the main issue was with who should be enforcing insider dealing regulations. In paragraph 228 of the Jenkins Committee's Report toyed with the idea of establishing a

[190] The Times, 'Insider dealing is 'no better than theft', SE chairman says', (1972) November 22 (London, England) Issue 58639. Self-regulation in the City meant that the participants were subject to their own rules or rules of the associations they were members of, see L C B Gower, 'Big Bang and the City Regulation' (1988) 51 Modern Law Review 1; C German, 'Don't outlaw insider deals says Wilkinson', (1972) 22 November, The Daily Telegraph (London, England), Issue 36552

[191] Sir Llewellyn Smith, *The Board of Trade,* (G P Putnam's Sons, Ltd. 1928)

[192] Rider and Hew (n 173)

[193] HC Deb 20 November 1978, vol 958, cols 929–1056

[194] DTI, Company division comments, September 28, 1976; DTI, Insider dealing report, August 1977; DTI, Office minute 654/77, June 3, 1977, TNA, BT 298/732

[195] The Companies Bill (1973) Cmnd 5391

[196] The Sunday Times, 'Harsh Words – Soft Centre', (1973) 29 July, 59

Securities Exchange Commission (SEC)-like independent body (like in the U.S.) to regulate the financial services sector,[197]

> 'We are not persuaded that a system of control on the U.S. model would work as well in this country as the more flexible though perhaps theoretically less perfect system which has grown up here over the years. But, given the wider devolution of control inherent in the British system, it seems to us that the present arrangement may be open to criticism on the ground that there is inadequate co-ordination of the experience and views of the Board of Trade and of the other bodies concerned with protection of the investor'

Although, it was acknowledged that the Board of Trade and other competent bodies lacked sufficient expertise to ensure investor protection, the Committee considered that there could be an independent body established. Following the JUSTICE Committee's Report and the White Paper of 1973, the Panel stated that it was successful in carrying out its tasks,[198] and that by creating another Commission would frustrate the effectiveness of the financial services industry.[199] This position was buttressed by various think tanks.[200] The Law Society averred that self-regulation was the appropriate system of supervision.[201] The Justice Committee also joined the discussion opining in favour of self-regulation, but it stressed that for as long as this system is capable of ensuring the investor protection.[202]

The final decision on this issue could not be reached due to a series of snap elections in the 1970s, though, the Labour Government (which was in power from 1974 until 1979) in its

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[197] Stamp and Marley (n 177)

[198] Today it is Rule 2.1 of the Code, and the Panel has a wide range of statutory powers set out in the Companies Act 2006, Chapter 1 Part 28. The full scope of the jurisdiction of the Panel can be found in Section 3 of the Introduction to the Code. These statutory powers were given in response to the European Takeover Directive 2004/25/EC of 21 April 2004

[199] The Panel Report 1974, 3

[200] December 1974 under the chairmanship of I.J. Fraser

[201] Law Society Gazette (1972), 36, 38

[202] Report on *Companies Commission*, October 1974

Green Paper[203] launched a scathing attack on self-regulation calling it out on being incapable of supervising and controlling its own members and proposed to create an independent Commission. However, they were not able to materialise their plans set out in the subsequent White Paper on the Conduct of Company Directors[204] because of yet another general election of 1979, in which the Conservative Party regained office. Insider dealing was criminalised in Part V of the Companies Act 1980.[205] The voluminous character of these provisions running to eight and a half pages of jargon-laden texts obscured the nature and purpose of insider dealing prohibition. This Part V of the Act 1980 with minor modifications was later consolidated into the Company Securities (Insider Dealing) Act 1985.

In the 1980s, the self-regulatory structure once again was tottering in the midst of enormous financial scandals.[206] The Lloyd's of London scandal sent the system quaking when a former head of an insurance syndicate syphoned off $60 million in insurance funds to himself and a small coterie of accomplices.[207] Another blow came about later when the price manipulation in the Guinness share-trading fraud came to light owing to American insider Ivan Boesky.[208] These are just a few examples of slipping through the cracks of self-regulation,[209] which were symptomatic of the flawed system which not only undermined the faculty of those regulators ensuring the protection of investors and the integrity of the financial system.

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[203] Report of a working group of the Labour Party Industrial Policy Sub-Committee (Green paper – Labour Party), 1 January 1974. See also T Hadden, 'The SEC and the City – Some thoughts on bureaucracies', (1975) Anglo-American Law Review 553

[204] The Conduct of Company Directors (1977) Cmnd 7037

[205] Sections 68-73

[206] For a general discussion see G.F. Filmott, 'The Reform of Investor Protection in the UK – An Examination of the Proposals of the Gower Report and the UK Government's White Paper of January 1985' (1985) 7 Journal of Comparative Business and Capital Market Law 141, 145, 146;

[207] S Lohr, 'Record fine by Lloyd's in final scandal inquiry', The New York Times (1985) November 13 available at https://www.nytimes.com/1985/11/13/business/record-fine-by-lloyd-s-in-final-scandal-inquiry.html

[208] N Kochan and H Pym, *The Guinness Affair: Anatomy of a Scandal*, (Helm, 1987). Ivan Boesky is considered to be the most notorious insider, who has been caught, in the history of insider dealing enforcement. He is his testimony during the criminal process in the U.S. (as a result of which he was fined a staggering $100 million on top of a prison term) in which he revealed that prior to a £4 billion takeover the price of Guinness shares was deliberately inflated through price manipulation

[209] Self-regulation here means that the regulators were the industry themselves

3.2. Reform proposals

It was recognised by the Government that the then regulatory framework was faltering, it was no longer able to sufficiently protect investors and the financial system.[210] Gower, a prominent academic, in the early 1980s was called in to review the legislation and make proposals for reform. Given the immense scope of the Report, only the relevant recommendations as to the regulatory structure will be discussed under which insider dealing would be enforced.

As regards a new regulatory structure, Gower aimed to find a halfway house between the Government and the City by setting up self-regulatory organisations (SROs) in each relevant sector but with the ultimate enforcement powers resting with a governmental body, that is to say to establish a two-tier regulatory system instead of pure self-regulation. Fusing self-regulation with governmental regulation would have tinges of rising neoclassical economics with minimum government intervention and fading away (post)-Keynesian economics with more pronounced government regulation.[211]

A self-regulation system has its advantages and disadvantages.[212] Under self-regulation decisions can be made and executed much quicker, because the Exchange or the Panel were participants and regulators in one person.[213] The issue with this fragmented regulatory framework was that, although, the enforcement of insider dealing regulations was a universal task amongst the SROs, but, due to the fact that each SRO having its own rules applicable only to members of that SRO, could potentially make the system cumbersome and not transparent.[214] Another factor which Gower highlighted in his Report was knowledge of self-regulators. The Exchange is an expert in its regulated area, but of course such knowledge did not spread over

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[210] D M Barnard, 'The UK Financial Services Act, 1986: A new regulatory framework', (1987) 21 The International Lawyer 343

[211] L C B Gower, Review of Investor Protection: Report, Part I, (1984) Cmd No 9215. See also M A Spitz, 'Recent Developments in Insider Trading Laws and Problems of Enforcement in Great Britain' (1989) 12 International and Comparative Law Review 265

[212] L C B Gower, Review of Investor Protection. A Discussion Document (HMSO, January 1982)

[213] Ibid

[214] Ibid

the criminal law, as it required not only specific expertise, but also concrete statutory powers.[215] This was not a problem for enforcement of insider dealing regulations as well, because as it will be seen later such statutory powers could have been given to the Exchange or the Panel by setting up a special criminal division unit in them. Therefore, there could have been a self-regulation system with powers to commence criminal prosecutions.

The third advantage of self-regulation identified by Gower was cost-effectiveness. Although, Gower underlined that the running down the costs of regulations could bring about even larger costs down the line, unless there is a solid back-up enforcement strategy.[216] This policy of cost-effectiveness is directly related to enforcement of insider dealing regulations, and it is still one of the pillars of detection, supervision and enforcement to be discussed later in chapter four. Cost-effectiveness can be understood by the fact that regulators would have limited resources, for example, financial, personnel, technological and so on, hence they could not act on each and every misconduct. That is, it is not feasible to enforce insider dealing regulations all the time, but only some instances. Therefore, such enforcement instances should be serious violations not trivial faults. If the regulator was to enforce inconsequential cases of insider dealing, this regulator would spend rather a similar amount of resources but without maintaining and/or amplifying a deterrent effect.

3.3. The new regulatory system

The Government's White Paper on Investor Protection endorsed Gower's proposal on a two-tier regulatory structure.[217] The Financial Services Act 1986 (hereinafter the FSA 1986) likewise set in motion 'Big-Bang' reforms',[218] propelling the City up the competition ladder.[219] These reforms allowed overseas firms to compete in the UK capital markets, differentiated

[215] Ibid

[216] Ibid

[217] White Paper, Financial Services in the UK: a new framework for investor protection, (1985) Cmd No 9432

[218] B Rider, K Alexander, S Bazley and J Bryant, *Market Abuse and Insider Dealing*, (3rd edn, Bloomsbury, 2016), para 3.4

[219] R Roberts, and D Kynaston, *City State: A Contemporary History of the City of London and How Money Triumphed* (London: Profile, 2001), 19-21

between the broker and the market maker, abolishing the fixed commission rule stimulating competition, ushering in automated trading superseding open outcry. It was owing to the latter reform, the Panel and the Exchange stepped up their monitoring capacity, and access to dealings to detect unusual price movements by deploying computer-based equipment.[220] And of course the creating of a two-tier regulatory structure.[221]

It should be noted that, together with the introduction of this new regulatory framework, the new consolidated provisions of insider dealing were enacted in the Company Securities (Insider Dealing) Act 1985 (hereinafter the IDA 1985) repealing the Companies Act 1980 with a potential imprisonment term on indictment conviction not exceeding two years, or summary conviction for up to six months. The new provisions slashed down the word count, but they were still drawn-out and complex, as the Parliamentary Under-Secretary of State for Corporate Affairs put it,

> '…the prohibition on a primary insider dealing is more than 100 words long – and on some occasions that complexity has not been helpful in the pursuit of offenders'[222]

According to the two-tier regulatory structure, an SRO would have to be recognised by the Securities Investment Board (the SIB), a non-governmental body acting as the principal regulator for the SROs. Each SRO was responsible for its specific area of regulation. For example, the Securities and Futures Authority, was regulating dealing in financial instruments, or the Personal Investment Authority was responsible for governing personal pensions, unit trusts, investment trust savings schemes and so forth. The SIB was authorised to undertake the following actions against authorised persons,[223]

* withdraw or suspend an authorisation, or suspend an individual from trading

* direct a disqualification order,

* publicly reprimand or censure,

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[220] The Takeover Panel 1968-1969 Report on the year ended 31st March 1987, 6

[221] For further information see C Bellringer and R Michie, 'Big Ban in the City of London: an intentional revolution or an accident?' (2014) 21 Financial History Review 111

[222] HC Deb, 12 June 1989, vol 154, col 661

[223] A Page and R B Ferguson, *Investor Protection*, (Weidenfeld and Nicolson, 1992)

* impose a fine

* delist

* carry out investigations.

None of the SROs was entitled to initiate criminal prosecutions against insider dealing. Their role was to be at the forefront of combating insider dealing filtering out suspicious transactions and passing them on the Department of Trade Inspection (hereinafter the DTI) for further decision. The DTI was given numerous statutory powers. The DTI could require firms and/or individuals to produce (all) required materials and question them upon request.[224] The DTI could conduct regulatory investigations into company ownership or share dealings[225] on the basis sections 432 and 447 of the IDA 1985. Section 432 of the IDA 1985 empowered the Secretary of State to appoint inspectors (who were mostly Queen's Counsel, or accountants) to investigate anything that was deemed to have a public interest with subsequent reporting.[226]

The other inferior powers were under section 447 the IDA 1985, which enabled the DTI to obtain documents with additional explanations as to the nature of these documents, but in a more confidential manner.[227] In the event a firm or an individual refused to comply with the DTI's requirements, the latter could apply to the court for penalising the non-compliant person for a contempt of court.[228] Under section 177 of the FSA 1986, the DTI could appoint inspectors or prosecute insider dealing itself without appointing inspectors, or authorise the Exchange to prosecute insider dealing under section 209 of Companies Act 1989, or take no further action.[229]

[224] IDA 1985 section 431(1)

[225] Ibid, s. 446

[226] For example, section 434 the IDA 1985 on production of documents and evidence to inspectors

[227] So that the company (or an individual) in question would not be put in the unwelcoming spotlight

[228] Section 56(5) Companies Act 1989

[229] Third Report, Company Investigations, Trade and Industry Committee, HC 36, 2 May 1990, para 143

3.4. Challenges to enforcing insider dealing regulations: move to a single regulatory framework

The DTI faced several challenges in enforcing insider dealing regulations, which can be categorised into three categories, namely, (i) the complexities of the two-tier system, (ii) the cumbersome nature of the criminal law,[230] and (iii) the 'lackadaisical' attitude towards the regulations.[231]

Consider the following real life example. The Exchange discovered that one man had dealt in shares on six separate occasions. The man resided on the same street as the Chairman of the public company in question.[232] The man profited from all his six deals, but when he was approached by the Exchange he simply chalked it up to a happy coincidence.[233] The Exchange could not prove the misconduct beyond reasonable doubt, and the inquiry was terminated. The question here is whether it was the burden of proof, or insouciant attitude of the Regulators, or possibly both?

Looking at the statistics of the insider dealing cases accomplished between 1980 and 1997 will show that the enforcement rates were rather risible with out of 22 convicted individuals,[234] only one served a custodial sentence.[235] The rest of sanctions were monetary

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[230] Ibid, para 153. According to the Chairman of the SIB the criminal law's burden of proof was almost unsurmountable, Daily Mail, 'Plea to curb City villains', (1990) (London, England) 23 April, Issue 29187. See also J Naylor, 'The Use of Criminal Sanctions by the UK and US Authorities for Insider Trading. How Can the Two Systems Learn from Each Other' (1990) 11 Company Lawyer 53; B Rider, 'Policing the City – Combating Fraud and other Abuses in the Corporate Securities Industry', (1988) 41 Current Legal Problems 47; J Welch, M· Pannier, E Barrachino, J Bernd, and P Ledeboer, *Comparative Implementation of EU Directives (I) – Insider Dealing and Market Abuse* (2005, The British Institute of International and Comparative Law, London); B Rider, 'Combating International Commercial Crime', (1985) Lloyd's Maritime and Commercial Law Quarterly 217

[231] The head of the SIB, Sir Large admitted that there was a feeling that fraud was going undetected leading to lack of confidence from the public, A Large, *Financial Services Regulation: Making the two-tier system work* 10 (SIB,1993) 8

[232] The Times, 'Insider dealers feel the heat', (1988) (London, England) 17 February Issue 63005

[233] Ibid

[234] In total 45 months suspended were imposed

[235] HC Deb, 01 July 1998, vol 315 cc215-6W

penalties rounded up coming to £93,000, not adjusted for inflation. For example, a former director of W H Smith was fined £800 and £100 towards enforcement costs after making a profit of £3,000.[236] In another case, Lutkins acting on a tip-off with his brother engaged in insider dealing, they were caught and fined £1972 including enforcement costs.[237] Or in the case of Gooding who after making a profit of £475 was sentenced to 120 hours' community service,[238] or two accountants were fined £1,500 each.[239]

Brian Sedgemore, MP for Hackney South and Shoreditch rather trenchantly pointed out the unconvincing attitude of the DTI towards insider dealing regulations. He gives an example that one of his friends, a lawyer defending people charged with fraud in the City when asked how could he got all of his clients off, responded that, '…it was the quality of prosecution. They treated it as though it was a kind of shoplifting case'.[240] Of course, there is no information as to whether these cases involved insider dealing or not, but this example points to some red flags concerning the overall enforcement strategy.

As it was indicated earlier in the chapter, the enforcement of criminal sanctions was meant to amplify deterrence in that would-be offenders would refrain from violating. In this context, the DTI, as it was mockingly labelled by the Times as 'the Inspector Clouseau of insider dealing',[241] highly likely did not achieve the deterrent objective but frittered away scarce economic resources. In fact, the Third Report on Company Investigations called into question the competence of the DTI in investigating the Barlow Clowes affair.[242] The DTI was unperceptive to massive press coverage about the conflict, but the DTI just 'did not read the

[236] L Lever, 'Insider deal director fined 800' (1986) The Times 29 April Issue 62443

[237] C Feltham, 'Lay preacher fined over insider dealing', (1990) Daily Mail (London, England) November 8, Issue 29358

[238] The Times, 'Insider made £475 profit after three days of deals' (1990) (London, England) 3 March Issue 63644

[239] The Times, 'Two accountants fined £1,500 each for insider dealing', (1994) 18 January Issue 64855

[240] HC Deb, 2 December 1986, Vol 106, col 796

[241] The Times, 'Tory calls for example to be made over insider dealing', (1986) (London, England) 3 December Issue 62631

[242] HC 36 (n 229) para 2

press'.[243] It suggests that the DTI was not for whatever reason interested in untangling this financial misconduct.

All of that was exacerbated by various complex rules and requirements imposed by the SROs perplexing the market participants.[244] It turned out to be that the SIB did not exercise sufficient control over the SROs which essentially transformed the two-tier system into a fragmented regulatory structure filled with at times contradicting regulatory objectives, in which each SRO looked after its responsibilities whilst disregarding the overall regulatory co-operation and cohesive performance.[245] There was yet another call for a reconsideration of the system.[246]

3.5. Single regulatory framework

The financial scandals of the early and mid-1990s[247] perhaps were the last straw before the Chancellor of Exchequer in his speech to the House of Commons harangued the two-tier system on failing to ensure investor protection.[248] Of course there had been some prosecutions, but largely the number of participants brought to book was relatively few making an impression

[243] Ibid, para 30

[244] The Economist, 'Catching London's culprits', (1993) (London, England) 3 April Issue 7805

[245] J Black, *Rules and Regulators*, (Clarendon Press, 1997); Financial Services and Market Bill, Bill 121 of 1998-99, Research Paper 99/68 24 June 1999, 21. See also the Chairman of the SIB's Report to the Chancellor on the Reform of the Financial Regulatory System (SIB, July 1997). HM Treasury, Financial Services and Markets Bill: A Consultation Document. Part One. Overview of Financial Regulatory Reform, (1998a), London, 8; C Fawcett, 'Examining the Objectives of Financial Regulation – Will the New Regime Succeed? A Practitioner's View', in E Ferran and C A E Goodhart, *Regulating Financial Services and Markets in the Twenty First Century*, (eds, Hart Publishing, 2001), 47

[246] The Economist, 'London's crumbling pillars', (1993) (London, England) 29 May Issue 7813, and The Economist, 'London's Regulatory mess', (1993) (London, England) 29 May Issue 7813

[247] Read for example about the Maxwell affair, R Ellison, 'Pensions Law reform after Maxwell: the possible content of new pensions regulations following the Maxwell case', (1993) 1 Journal of Financial Regulation and Compliance 278. Or about the collapse of Baring's Bank, H Drummond, 'Living in a fool's paradise: the collapse of Barings' Bank', (2002) 4 Management Decision 232

[248] The Chancellor's Statement to the House of Commons on the Bank of England 20 May 1997

that the financial services industry was riven with scandal.[249] A new single regulatory framework was considered to be more efficient in accordance with the following two arguments, first, a one-regulatory shop would rectify the challenges of the previous fragmented framework, and second, this new regime would incorporate clear lines of accountability for regulatory failures.[250] The overall approach to financial regulations would be subject to a risk-based approach, that is, resources would be divvied out to the riskiest areas.[251]

This new single regulator was named the Financial Services Authority (hereinafter the FSA), which de facto replaced the SIB in 1997, and also took over the tasks and responsibilities of all the SROs; the Supervision and Surveillance Department of the Bank of England was no longer supervising banks, now it was also delegated to the FSA. The FSA received statutory powers and status through the Financial and Services Markets Act (hereinafter the FSMA 2000) in December 2001. The organisational structure of the FSA was similar to that of the SIB, a non-governmental body, a company limited by guarantee funded through the contributions made by the firms it supervised. The FSA had to fulfil the four statutory objectives,[252] (i) to maintain market confidence, (ii) to promote public awareness of the financial system, (iii) to protect consumers, and (iv) to reduce financial crime. In addition to numerous regulatory and statutory powers, the FSA was empowered to enforce a new civil market abuse regime.

3.6. Civil Offence of Insider Dealing

In response to the challenges associated with the criminal regime, that is, the high criminal law's burden of proof, the narrow scope of the CJA 1993 and the length of criminal prosecutions, the Government got a new civil regime through the FSMA 2000. It should be noted that section 118 of the FSMA 2000 introducing the civil regime against insider dealing was subsumed by the Market Abuse Regulation 2016 to be discussed in the next chapter. Regarding the length of prosecutions, the chapter will look at the enforcement rate of civil cases

[249] H Davies, 'Are words still bonds: how straight is the City?', Chairman, FSA, Speech at the Securities Institute Ethics Committee, 3rd Annual Lecture, London, 2 November 1998

[250] Ibid

[251] C Briault, 'The rationale for a single national financial services regulator', (1999) FSA, London

[252] Now repealed sections 3, 3A, 4, 5, and 6 Part 1 FSMA 2000

in a period from 2000 until 2021, when the FSA was superseded by the Financial Conduct Authority.

3.6.1. Reasoning behind introduction of civil sanctions

The underlying justification for introducing the civil regime was made clear in 1990, when the Trade and Industry Committee singled out the criminal law's standard of proof as the main obstacle impeding regulators to enforce the law.[253] However, in 1990, the Government were not yet ready to substitute the criminal law by the civil law,[254] as the Secretary of State put it,

> 'I am not convinced that a change from criminal to civil law would significantly increase the number of cases before the courts…[T]he real issue is the detection and deterrence of insider dealing'[255]

This passage points out that the problem was not only the standard of proof, but also the detection and deterrence of insider dealing. As it will be shown in chapters five and six, detection is an element of the deterrence certainty criterion, so essentially the problem identified by the Secretary of State was about delivering deterrence. Possibly, the meaning behind separating detection from deterrence was to differentiate between the certainty and severity criteria of deterrence. The differences in challenges between these two criteria are that the certainty criterion can be balanced out by the availability of sufficient legal powers and expertise, whereas the severity criterion depends on the gravity of insider dealing. As it was pointed out this discussion will be picked up later in the thesis, but to be clear deterrence having been acted as the lynchpin of the insider dealing regulation was recognised as a challenge in and of itself.

253 The White Paper Company Investigations (1990) Cm 1149, 17, 18

254 HC 36 (n 229)

255 Ibid, para 162. Examination of witnesses of 7 February 1990, para 825 per Lord Ripley

Ten years later the FSMA 2000 introduced a civil offence of market abuse, which includes insider dealing alongside market manipulation.[256] A new civil offence of insider dealing aimed to be 'an important addition to the FSA's armoury to tackle abuse of the financial markets'.[257] David Kidney, MP explicated the purpose of the civil regime in the following way,[258]

> '[I]s intended to complement the existing criminal law controls over insider dealing and market manipulation.'

But, he continued that,

> 'I hasten to add that it would be wrong to apply a new civil regime solely for the purpose of making it easier to catch criminal wrongdoers by widening the range of conduct that may be caught and lowering the standard of proof needed to prove our case. However, it is an inescapable fact that existing criminal offences have not been adequate to control market abuse misbehaviour'[259]

The problem with length of prosecutions was outlined in paragraph 110 of the Third Report,

> '…(Committee) [C]oncerned however at the length of time taken to bring these (insider dealing) large cases to court. The interval between the action and the penalty is too long'.

The length of criminal prosecutions/proceedings was deemed to be too rigid for achieving the regulatory goals of reducing the incidence of insider dealing. In this connection, the average time for completion of a basic fact-finding was eleven months, and major investigations consumed on average two years and four months.[260] With a view to slashing this overly long

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[256] First Report ordered by the House of Lords and the House of Commons 27 April 1999. This offence was market manipulation and insider dealing, later it was enshrined in section 118 FSMA 2000, which is now in the UK Market Abuse Regulation

[257] HC Deb, 5 June 2000, vol 351, col 82

[258] Ibid

[259] Ibid

[260] HC 36 (n 229) para 47

time down, the Committee suggested following the Inland Revenue's practice in dealing with stamp duty violations,

> '[O]nce the DTI has received a report from the Exchange on insider dealing it could require the person concerned to answer questions (subject to the normal protections). On the basis of these a statement of facts could be served on him. If he did not dispute them he could pay a fixed penalty. If he did dispute them he could appeal to the courts, which would have the option of imposing a larger penalty. We believe in practice that most cases would be settled at an initial stage'[261]

This recommendation of following the Inland Revenue approach was believed to expedite cumbersome insider dealing investigations so that a person under investigation can settle a case straight away, or within a much shorter timeframe, without undergoing the time and resource consuming formal process of criminal proceedings. However, such an approach had tinges of increasing the quantity of insider dealing cases, but not necessarily the quality of cases. The existing academic literature is silent on the relationships between the criminal and civil regimes' deterrent effects. It might have been that the idea behind the dual regime was conducive to marginal deterrence,[262]but there is no reference to it and as it was discussed in chapter one, there has been a presumption of deterrence without differentiating between the regimes. Perhaps, it is because, as it will be shown in the next sections, the civil regime has turned out to be no less stringent than the criminal regime.

Another point was that on the surmise that the civil regime's burden of proof was less strict, it would take less time to carry out a civil case of insider dealing. Later in this chapter these two justifications will be looked at, but as a concise conclusion it is possible to believe that the overall lethargic approach to insider dealing regulations dragged the criminal law to the gallows to be saved by the civil regime. Stripping the criminal regime of its monopolist status, the introduction of the civil regime fit squarely in the light-touch philosophy as

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[261] Ibid, para 163

[262] R A Posner, 'An Economic Theory of Criminal Law', (1985) 85 Columbia Law Review 1193, 1207; it might be

discussed in chapter two. But it did not imply that in reality civil sanction were less deterrent, or that a civil case of insider dealing would be easier to accomplish.[263]

Chapter five and chapter six will delve into the challenges associated with the civil regime in great detail, for the purposes of this chapter, the problem with the civil regime is that a deterrent effect of a civil sanction is less conspicuous than that of a criminal sanction given that, as it will be shown later, the civil burden of proof as well as length of prosecutions turn out to be roughly similar between the regimes.

In economic-driven crimes a deterrent effect from a criminal sanction is easier to conjure up and infer, because this criminal sanction will highly likely overcome gains from insider dealing.[264] That is, a criminal sanction if set to its maximum, that is, 10 years imprisonment coupled with a financial fine and if any administrative sanctions is more straightforward as there is little leeway for an insider in terms of getting off a custodial sentence. A caveat here is that for this criminal sanction to be a deterrent there should be a reasonable level of certainty of punishment, as if there is a zero or close to zero probability of apprehension, then surely any potential deterrent effect is likewise close to zero,

A civil sanction in economic-driven crimes seems to be more difficult to deduce, as it will likely not overcome gains from insider dealing. Setting a civil sanction to its maximal level will be problematic because, a penalty should meet the proportionality principle, and an insider may have no wherewithal to afford the fine. Since insider dealing is committed for monetary considerations as it was mentioned in footnotes 27 and 144, in a civil case with no possibility of a looming criminal conviction, it is plausible to come up against a challenge to producing a deterrent effect that will be sufficiently strong to dissuade other would-be offenders from violating.

This distinction is important, in that, a deterrent effect in the criminal regime is represented as a function of the possibility of conviction, with any other concomitant sanctions, plus the quantified monetary benefits and other concomitant aggravating and mitigating factors. Whereas a deterrent effect in the civil regime is represented as a function of a monetary

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[263] M Cole, 'How Enforcement Makes a Difference', Director of Enforcement, FSA, at the Enforcement Law Conference, 18 June 2008

[264] J L Wielhouwer, 'When is public enforcement of insider trading regulations effective?' (2013) 34 International Review of Law and Economics 52

penalty, with other disciplinary or administrative sanctions given the person to be penalised is a regulated and authorised person, plus the quantified monetary benefits and other concomitant aggravating and mitigating factors.

3.6.2. Enforcement of the civil regime

The FSA's approach to enforcement of insider dealing regulations can be divided into two periods, the first period of light-touch approach to regulations before the financial crisis of 2007/09, where the FSA had not been focusing on credible enforcement.[265] In particular, the FSA was running down the number of enforced cases each year and mainly focusing on supervisory discussion.[266] The second period witnessed more aggressive enforcement after the crisis. The crisis unveiled the numerous regulatory setbacks, so the FSA had to rectify itself and therefore initiated more prosecutions, but still enforcement activities, as it will be seen later, were subject to the risk-based approach, i.e., those matters posing the greatest risk to the statutory objectives would be looked into first.[267]

Initially, the FSA carried on maintaining the passed down by the DTI a fairly modest level of enforcement,[268] which fit snugly into the overall FSA's a non-zero failure regime.[269] This non-zero failure approach means that the FSA could not detect and enforce every potential violation, and even when the FSA initiated a prosecution it did not expect to win every case. Regarding the latter, in fact, it was not considered to be a failure, on the contrary, the FSA spun it as that a hundred per cent successful enforcement rate would indicate that the FSA was not

[265] D Medland, 'Interview - with Margaret Cole, former FSA 'enforcer', FT, (London, 23 May 2013), available at https://www.ft.com/content/261835e8-a02e-11e2-a6e1-00144feabdc0, accessed 25 July 2023; M Cole, 'Insider dealing in the City', Director of Enforcement, FSA, Speech at the London School of Economics, 17 March 2007. See also A H Baker, 'Insider dealing', in eds. N Ryder, *Financial Crime in the 21st Century*, (Edward Elgar, 2011)

[266] J Tiner, CEO, FSA, Speech at the FSA Enforcement Conference, 6 September 2004

[267] Ibid

[268] Ibid

[269] H Davies, 'A radical new approach to regulation', Chairman, FSA, Keynote Speech 'A new regulator for the new millennium', at the Proceedings of FSA Conference at the Royal Lancaster Hotel, London 11 December 2000

taking on complex cases.[270] Although, it might have been correct in expecting that some cases would be lost before a tribunal or court, but this was arguably difficult to ascertain whether any lost case was actually a complex one. The FSA stuck to prophylactic supervision, that is, there was no need for enforcement since the FSA conducted effective supervision.[271] This effective and efficient supervision was to be propped up by the regulated firms installing and maintaining the appropriate internal systems and controls to minimise the risks of any regulatory violation.[272] In this connection, a great deal of attention in this approach was paid to collaborative work with the senior managers of regulated firms.[273] In which, the senior management should have understood and ensured that they realised and mitigated risks.[274]

3.6.3. Civil cases accomplished between 2000 and 2013

Table 1 lists the civil enforced cases against insider dealing for a period between 2000 and 2013. The full list of the civil cases brought by the FSA and the FCA from 2000 until 2023 are provided in Appendix A.

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[270] Tiner (n 266)

[271] Medland (n 265)

[272] H Davies, 'Financial Regulation and the Law', Chairman, FSA, Speech at the Chancery Bar Association and Combar Spring Lecture Lincoln's Inn, London, 3 March 1999; M Cole, 'Enforcement priorities and issues for 2006', Director of Enforcement, FSA, Speech at the SII Compliance Forum, 18 January 2006

[273] Ibid

[274] S Dewar, 'Preventing and combating market abuse', Director of Markets Division FSA, Speech at the Wholesale Conference, QEII Conference Centre 17 May 2006

Table 1. The civil cases against insider dealing brought from 2000 until 2013.

Source: FSA's Final Notices

Name	Penalty date	Penalty amount	Conduct
Robert Middlemiss	10.02.2004	£15,000	Dealing. Avoided a loss in the amount of £6,825. Committed in April 2002
Peter Bracken	7.07.2004	£15,000	Dealing. Profit in the amount of £2,824. Committed in September 2002
Michael T. Davies	28.07.2004	£1,000	Dealing. Profit in the amount of £420. Committed in January 2004
Jason Smith and Robin Mark Hatchings	13.12.2004	£15,000, £18,000	Disclosure. Profit in the amount of £4,924. Committed in April 2003
David Isaacs	28.02.2005	£15,000	Disclosure. Committed in September 2003
Arif Mohammed	18.05.2005	£10,000	Dealing. Profit in the amount of £3,750 . Committed on 29 November 2002
Jonathan Malins	20.12.2005	£25,000	Dealing. Profit in the amount of £6,400. Committed in March 2005
Philip Jabre and GLG Partners LP	01.08.2006	£750,000[275]	Dealing (short sale). Profit in the amount of £500,000. Committed in February 2003
Sean Julian Pignatelli	20.11.2006	£20,000	Failed to file a suspicious transaction report
James Boyd Parker	6.10.2006	£250,000	Dealing (spread betting). Profit in the amount of £150,000. Committed on 27 February 2002

[275] Tribunal Decisions FSMT Case 035 10/07/2006, and case 036 10/07/06. In this case principles of vicarious liability were applied. Mr. Jabre on behalf of the GLG Market Neutral Fund which he managed for GLG, improperly short-sold ordinary shared in Sumitomo Mitsui Financial Group Inc the value of $16 million ahead of an announcement of a new issue of convertible preferences shares in SFMG

Bertie Charles Hatcher	13.05.2008	£56,098	Dealing. Disgorgement. Committed in 2003
John Shelvin	1.07.2008	£85,000	Dealing. Profit in the amount of £38,472. Committed in January 2006
Steven Harrison	8.09.2008	£52,500	Encouragement. Profit in the amount of € 44,000. Committed in September 2006
Richard Ralph, Filip Boyen and Erik Boyen	12.11.2008, and Erik Boyen 12.01.2009	£117,691 £81,982 £176,253	Dealing and disclosure. Richard Ralph profited £12,691. Filip Boyen profited £29,482, and Erik Boyen profited £127,254. Committed in January 2007
Stewart McKegg and Brian Valentine Taylor	16.12.2008	£14,411 £4,462	Dealing. Disgorgement. Committed in May 2007
Andre Scerri	29.10.2010	£66,000	Dealing. Profit in the amount of £46,000. Committed in May 2007
Darwin L. Clifton and Byron Holdings	27.01.2009	£59,900 and £86,030	Encouragement. Committed between November 2007 and February 2008
Mark Lockwood	1.09.2009	£20,000	Failed to file a suspicious transaction report. Committed in May 2007
Darren Morton and Christopher Parry	6.10.2009	Public censure	Dealing. Committed in March 2007
Alexei Krilov-Harrison	3.11.2009	£24,000	Disclosure. Committed in March 2007
Mehmet Sepil, Murat Ozgul and Levent Akca	12.02.2010	£967,005, £105,240 and £94,062	Dealing. Committed in May 2009
Robin Chhabra and Sameer Patel	16.04.2010	£95,000 and £180, 541	Disclosure. Committed in 2004
Jeffery Burley and Jeremy Burley	19.07.2010	£35,000 £144,200	Dealing. Profit in the amount of £21,700 (avoided loss). Committed in June 2009

Perry John Bliss	14.12.2010	£30,000	Disclosure. Disciplinary sanction, prohibition to carry on regulated activities. Committed in March 2007
William James Coppin	14.12.2010	£70,000	Disclosure and encouragement. Disgorgement and the Prohibition Order. Committed in March 2007
David Massey	21.02.2011	£150,000, and a prohibition order	Dealing. Profit in the amount of £111,474. Committed in November 2007
Caspar Agnew	3.10.2011	£65,000	Failed to file a suspicious transaction report. Committed in June 2009
David Einhorn and Greenlight Capital	15.02.2012	£3,638,000	Dealing. Committed in June 2009
Andrew Osborne	15.02.2012	£350,000	Disclosure. Committed in June 2009
Nicholas Kyprios	13.03.2012	£210,000	Disclosure.

This thesis cannot stress enough the importance of the case against Einhorn, President of Greenlight Capital Hedge Fund. Peculiarly, this case simultaneously records the highest financial penalty imposed against an individual, £3,638,000, but for him avoiding a loss of more than £5,000,000. In June 2009, was wall crossed[276] by an employee of Merrill Lynch International, who was a joint book runner[277] and co-sponsor in relation to the sale of Punch Taverns Plc.,[278] Einhorn avoided losses by disposing of the shares in the firm. The financial penalty imposed was therefore lower than the amount of illegal gains in the form of loss avoidance.[279] The FSA did not comment, explicate, nor pay attention to this egregious fact, which in points to the possibility of imposing a disproportionately small penalty to the quantified illegal benefits thereby diminishing deterrence. In paragraph 6.11 of the Final Notice to Einhorn, the FSA found that his dealing was inadvertent, as he did not act deliberately or

[276] It is similar to market sounding see the Glossary

[277] A book runner is the main underwriter of equity (or debt and so on), i.e. calculated and took on the risks of Punch

[278] FSA, Final Notice to David Einhorn, 15 February 2012

[279] Ibid, paragraph 2.3

recklessly, concluding that 'His failure to apply the necessary care and rigour, while unintentional, was an extremely serious matter, and warrants a substantial penalty'. Since there is no reliable information as to why such a disproportionate penalty was meted out, this thesis will not engage in speculation but this problem of imposing a disproportionately small penalty will be discussed in more detail in chapter six.

However, this thesis believes it is consequential to reflect on the Einhorn case by theorising that potentially a profit or loss avoided are just approximations. Even when the FSA in its Final Notices indicated a *precise* amount of quantified illegal gains, there is still some uncertainty and suspicion as to the accuracy of these quantified amounts. This *precise* amount cannot be taken as read and therefore there was, and still is a quantification issue. Manne confuted the effectiveness of insider dealing regulations on account of the impossibility of quantifying illegal gains,[280] and this thesis will subscribe to this opinion and attempt to unravel this issue later in the discussion. The concern raised in this section of the thesis is that the FSA might have been incorrect in their calculations, but while the criminal regime had a possibility of a custodial sentence which could arguably cancel out the quantification issue as it will be further examined in chapter five, the civil regime did not have such a possibility. As a result, it was likely that a civil fine would undermine a deterrent effect as insiders may come out on top in the end.[281]

3.6.4. Standards of proof

To understand whether the criminal law's standard of proof was and has been a challenge to enforcement as well as whether the introduction of the civil regime alleviated this challenge by lowering the burden and shaving off the length of investigations, this part of the thesis will look at the criminal cases brought by the FSA as shown in Table 2 below. The full list of the criminal cases brought by the FSA and the FCA is provided in Appendix B.

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[280] Manne (n 30)

[281] B Morris, 'Insider trading: a cancer in the market', (1986) The Times (London, England) 2 December Issue 62630

Table 2. The criminal cases accomplished by the FSA

Source: FCA website[282]

Names of convicted persons	Date of decision	Sentence
C McQuoid and J Melbourne	27.03.2009	Two individuals, sentenced to eight and twelve months respectively
R Uberoi and M Uberoi	6.11.2009	Two individuals, sentenced to two-, and twelve-months imprisonment respectively
M Calvert	7.05.2010	Imprisoned for 21 months
M McFall, A King and A Rimmington	1.05.2010	Three individuals were acquitted
N Rollins	07.2010	15 and 21 months sentenced (to run concurrently)
A Ahmad	22.06.2010	Ten months suspended for two years
R Sidhu	25.12.2011	24 months
C Littlewood and A Littlewood, and O Sa'aid	2.02.2012	Three individuals, three years and four months, the second defendant to a suspended term of twelve months, and the third to 24 months
C Hossain and A Buck	20.06.2012	Two individuals were acquitted
J Sanders, M Sanders and J Swallow	20.06.2012	Three individuals. The primary insider was sentenced to four years, the other two defendants to ten months
A Mustafa, P Saimi, P Shah, N Shah, B Shah and T Patel	27.07.2012	Six individuals, three of which were sentenced to three and a half years imprisonment, one to 18 months, and the other to two years

[282] Insider dealing convictions can be found at the FCA's website accessible at https://www.fca.org.uk/search-results?search_term=insider%20dealing

T Amman, and C Weckwerth and J Mang	24.12.2013	Three individuals, one sentenced to 18 months, the other two acquitted
R Joseph	11.03.2013	Sentenced to four years
P Milsom	17.03.2013	Sentenced to two years

The first successful criminal cases were concluded in 2009, that is, about nine years after the introduction of the civil regime. Margaret Cole was the head of enforcement and crime division at the FSA in the late 2000s, after a series of successful criminal and civil cases she pointed out that the civil law's standard of proof was in no way less demanding than that of the criminal law.[283]

In *R v Hepworth and Fearnley,* Lord Goddard, LJ was unable to distinguish the differences between the standards.[284] The civil standard of proof is a balance of probabilities that implies that the court must be satisfied that something in issue is more likely to have occurred than not.[285] Lord Denning explains this in the following way, if the court believes that one event is more probable than not, the burden of proof is met, that is, the factfinder is satisfied that certain facts are true, if not, then the burden is in the balance.[286] To illustrate this principle, consider a scale of 0 to 1, where a value close to 0 signifies that an event is unlikely to have taken place, and a value near 1 signifies that an event is highly likely to have taken place, when some facts lie in between then they are in the balance.[287] This scale hinges on the subject-matter of any given case. In *Bater v Bater*, Lord Denning postulated that in a civil case there may be various degrees of probability, for example, in cases of fraud it will be necessary to set a higher degree of probability.[288] That is, the more serious the allegation is, the higher the degree of

[283] Cole (n 263)

[284] [1955] 2 QB 600

[285] *Re H (Minors) (Sexual Abuse: Standard of Proof)* [1996] AC 563 per Hoffman

[286] *Miller v Minister of Pensions* [1947] 3 All ER 372 at 373

[287] M Redmayne, 'Standards of proof in civil litigation', (1999) 62 The Modern Law Review 167

[288] [1950] 2 All ER 458, see also *Re Dellow's Will Trusts* [1964] 1 All ER 771 per Ungoed-Thomas J

probability is required[289] making the civil standard of proof flexible.[290] This flexibility was further expanded in *Hornal v Neuberger Products Ltd* that the standard of proof can remain intact, but the degree of evidence needed to satisfy the standard rises, as more serious events are said to be less probable.[291]

The first civil case against insider dealing which was submitted to the Financial Services and Markets Tribunal (hereinafter the FSMT), the defendant argued that there should have been the criminal law's standard of proof. The FSMT was set up by section 132 FSMA 2000 to amongst other things review the decisions of the FSA, the FSMT was abolished and replaced with the Upper Tribunal in accordance with the Tribunals, Courts and Enforcement Act 2007. The FSMT on that occasion sat with the FSA rebuffing this argument, but it was admitted that in line with the relevant case law the more serious the allegation the more cogent should be the evidence to back it up.[292] In *B v Chief Constable of Avon and Somerset Constabulary*, Lord Bingham spells out the civil standard of proof as not a bare balance of probabilities, but as a flexible standard to be applied with greater or lesser strictness according to the gravity of what had to be proved to the point where the difference between the criminal and civil standards of proofs become illusory.[293] In such situations, it may be said that the criminal and civil standards of proofs produce quite similar outcomes.[294] To put it differently, given the dual-regulatory framework, the civil regime's standard of proof can be pushed upwards to that of the criminal regime's standard of proof.

In another case conducted by the FSA against James Parker, who likewise submitted his case to the FSMT, he argued that the FSA could have prosecuted his case under the criminal regime but had chosen to go down the civil path.[295] The FSA had imposed a staggering £250,000, i.e., the FSA deemed this case to be a flagrant violation of insider dealing regulations calling for a high deterrent penalty, but through the allegedly lower civil standard of proof. The

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[289] Ibid, at 973

[290] Ibid, per Lord Hobson

[291] [1956] 3 All ER 970

[292] *Arif Mohammed and FSA*, March 2005

[293] [2000] EWHC 559 (QB), 31

[294] *R v Mental Health Review Tribunal (Northern Region)* [2005] EWCA Civ 1605, at 69 per Richards, LJ

[295] *James Parker and FSA*, May 2006, para 16

FSMT in this case heightened the civil standard of proof nearing the criminal standard of proof by referring amongst other cases to *R v Mental Health Review Tribunal (Northern Region) and others,* where Richards LJ points out that it is important to take into account the consequences of proving.[296] What it means is that when a serious matter is disputed, the heightened civil standard of proof is necessary that can make it indistinguishable with the criminal law's standard.[297]

Another issue to bring up is that in this case the FSMT looked at Article 6 of the European Convention on Human Rights of 1953 (hereinafter ECHR).[298] It was recognised by the Upper Tribunal that the reasoning in *Fleurose v The Securities and Futures Authority Ltd*[299] in which Schiemann LJ lays out the three criteria from the jurisprudence of the ECHR. First, the categorisation of the allegation in domestic law, second, whether the offence is one which can be committed by any member of the public or only by a member of a closed group, and third, the nature of the penalty which may be imposed. If a proposed penalty is a punitive and deterrent, the offence is likely to be regarded for the ECHR purposes as criminal in character with all rights ensuing from it. In the civil case of James Parker, the FSA was intent on making its penalty punitive and deterrence, so based on Article 6 of the ECHR, this proposed penalty of £250,000, could have been treated as a criminal charge despite that it was initiated under the civil regime.[300] However, the FSMT in this case points out that Article 6 of the ECHR does not require the prosecutor to establish the charge under the criminal standard of proof. [301] But the FSMT fully recognised that the more improbable the event, the stronger must be the evidence

[296] *R v Mental Health* (n 294)

[297] *Regina (McCann and Others) v Crown Court at Manchester and Another,* [2002] UKHL 39, at 37 and 83

[298] Article 6(1) of the ECHR sets out the following, 'In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgement shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice, (2) everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law'; Baker (n 165)

[299] [2001] EWCA Civ 2015

[300] Ibid, para 20

[301] Ibid, para 22

that it did occur,[302] especially given the fact that the proposed penalty was immense, the FMST concluded that it was extremely difficult to draw a meaningful distinction between the civil and criminal standards of proof.[303]

3.6.5. Length of prosecutions

As it was pointed out earlier in this chapter, not only the standard of proof was regarded as a stumbling block to the effective enforcement of insider dealing regulations, but also, the protracted length of criminal prosecutions. Assessing whether in fact the length of prosecutions is shorter in civil cases can corroborate the aforementioned discussion on the indistinguishability of the criminal and civil standards of proofs in serious cases. In order to carry out such an assessment, we computed and compared the difference between the periods when the FSA and the FCA believed to be the dates of insider dealing, and the dates when the final notices were issued against the insiders by the FSA and also the FCA.

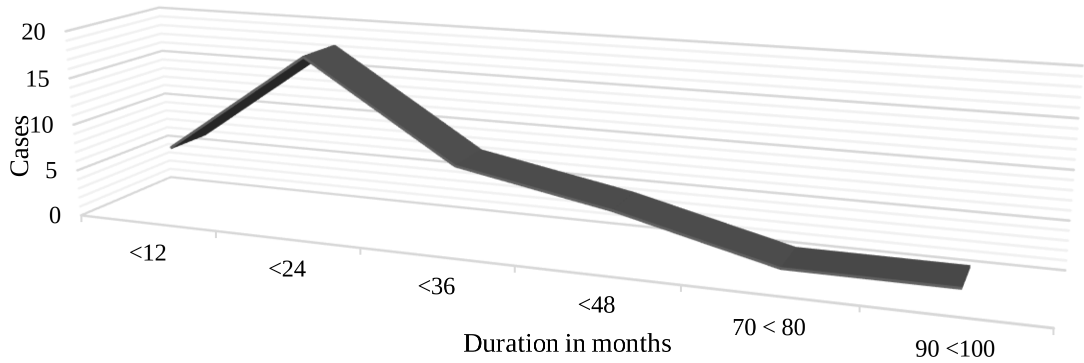
The total number of cases against individuals used in this analysis is 40 between 2000 and 2021. Figure 1 below shows the following results, seven cases were finished within 12 months, 18 civil cases were completed within a period between 12 and 24 months, eight cases were concluded within a period of over than 24 months but less than 36 months, five cases were accomplished within 48 months, and two cases lasted for over 70 months but less than 100 months. The average time spent on carrying through a civil insider dealing case comes to around two years and five months. This illustrates two points, first, the civil regime has not lopped time off criminal prosecutions, second, the civil standard of proof is not less complicated than that of the criminal one pointing to the additional challenge to the effective enforcemet of insider dealing regulations and generation of a deterrent effect.

[302] Ibid, para 21

[303] Ibid, para 23

Figure 1. The civil cases concluded in a period of 2004 to 2021.

Source: Final Notices.



Purely out of curisoity, a Pearson correlation test was carried out to measure the strength of the linear relationship(s) between the length of civil cases and severity of financial sanctions. The Pearson correlation coefficient is 0.06994, which means that there was no significant association between these two variables. This result can be important for at least two reasons. First, under the assumption that the longer it takes for the Authority to complete a civil case against insider dealing, the more resources the Authority should invest, but since there was no correlation between these two variables, it could mean that some cases were trivial in the sense that the resources spent had not been compensated by an increased deterrent effect.

A caveat should be entered here. For the sake of this analysis it is assumed that the date on which insider dealing was committed for the first time, as it is indicated in a Final Notice and the date of issuance of that Final Notice represents the length of a case. But it may be the case that the former just shows the date of proven insider dealing, but the actual duration of investigations was shorter. Therefore, it is important to distinguish between the actual length and the observed length of investigations. For example, a Final Notice specifies that the penalty is imposed against insider dealing which was committed on the 1st of January 2015. The date of this Final Notice is the 1st of January 2020. The question is, did the FCA investigate this case for five years, or did the FCA set out to investigate this case say in 2016, 2017 and so on thereby disposing of the case in much shorter timeframes? Could it be that the FCA accomplishes this case within three months? Since there is no statute of limitations in insider dealing cases answering this question is problematic, therefore the conclusions were drawn on the basis of observed frequencies.

3.7. FSA approaches to regulations

Only those approaches will be discussed which were relevant to insider dealing. Some of the approaches, namely, the principles-based and risk-based approaches were modified and are still used today by the Financial Conduct Authority. For that reason, these two approaches will only be touch upon in chapter four.

3.7.1. Principles-based approach

The principles-based approach to financial regulations emerged as a result of the Memorandum by HM Treasury on the Financial Services Authority setting down the seven principles of good regulation which the FSA had to have regard in the course of discharging its general functions.[304] The move towards more principles-based regulation would give firms more flexibility to innovate as to how they achieve the outcomes the FSA was seeking.[305] These Principles were,

Principle 1. The need to use its resources in the most efficient and economical way,[306]

Principle 2. Recognition of the responsibilities of regulated firms' own management,[307]

Principle 3. Proportionality between the burden, or restrictions imposed on a regulated body in relation to the benefits,[308]

Principle 4. The desirability of facilitating innovation in connection with regulated activities,[309]

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[304] Memorandum by HM Treasury on the FSA, Select Committee on Constitution Minutes of Evidence, HM Treasury 25 March 2003

[305] D Waters, Director Retail Policy Division, FSA, Keynote Speech at NEWCOB briefings, January/February 2007

[306] Today this principle is called efficiency and economy

[307] Today this is principle 5, senior management responsibility

[308] This principle is not included in the list, but it resembles principle 2, proportionality

[309] Today this principle resembles principle 3, sustainable growth

Principle 5. The international character of financial services and markets and the desirability of maintaining the competitive position of the UK, [310]

Principle 6. The need to minimise the adverse effects on competition that may arise from anything done in the discharge of its functions,

Principle 7. The desirability of facilitating competition between those who are subject to any form of regulation by the FSA.

Principle 1 was relevant to insider dealing regulations in that only serious instances of insider dealing to be enforced. At the time of the introduction of these principles in 2003, the FSA had yet to enforce a single case of insider dealing. Recall that the first civil case was enforced in 2004, and the first successful criminal case was accomplished in 2009. In congruence with the overall minimal intervention approach to financial regulations,[311] and according to Principles 2 and 3, the FSA entrusted the senior management with the task of assessing their risks and identifying and preventing misconduct.[312] In this connection, these two Principles enshrined the idea of co-operation between the FSA and the regulated firms who had to comply with High Principles of good business.[313] In particular, High Principle 2 obliges a firm to conduct its business with due skills, care and diligence. In terms of insider dealing, this means that firms should install and maintain effective internal systems and controls which is furthered in High Principle 3 on risk management and control and High Principle 5 that firms must comply with and observe proper standards of market conduct.

By so approaching financial services regulations, the FSA aimed to maximise the incentives of senior management to ensure that a firm followed good business practices believing that senior management should be far more influential with their staff than the FSA could be. Likewise, this approach implied that where and when failures occur, senior management would take its appropriate share of responsibility for the consequences of those

[310] Ibid

[311] J Tiner, CEO, FSA, Speech at the FSA Annual Meeting, 19 July 2007

[312] FSA, Annual Report 2001/02

[313] FSA, Policy statement, 'The FSA Principles for Businesses', Response on Consultation Paper 13, October 1999

failures.[314] On the flip side, there should be credible enforcement action to reinforce the message when behaviour and outcomes fall short of High Principles.[315] But as it will be seen later in the chapter, prior to the financial crisis of 2007/09 this expectation was undermined due to the light-touch approach to regulations.[316]

It should be noted that, the FSA transformed the principles-based approach to a new outcomes-based approach to regulation.[317] This shift in the principles-based approach signified that instead of expecting compliance from firms, it would be more effective to focus on the outcomes and consequences of their decisions.[318] That is, the outcomes-based approach even deeper pulled in the senior management, but they now had to comprehend what these principles actually pursued, also promote sustainable business strategies and account for associated risks, rather than expect the senior management to make correct decisions, or simply maintain the minimum compliance level.[319]

3.7.2. Light-touch approach

The light-touch approach to regulation can be understood from the following statement,

> '…[M]arket participants can do what they want unless we say they cannot, rather than that they can only do what we say they can'.[320]

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[314] H Davies, 'Are words still bonds: how straight is the City?', Chairman, FSA, Speech at the Securities Institute Ethics Committee, 3rd Annual Lecture, London, 2 November 1998

[315] M Cole, Director of Enforcement, FSA, Speech at the FSA Enforcement Briefing - BBA Conference, 14 March 2007

[316] FSA, Internal Audit Division, 'The supervision of Northern Rock: a lessons learned review', Report March 2008, para 5 Part C

[317] FSA, Annual Report 2008/09, 10; FSA Annual Public Meeting, per H Sants, CEO

[318] H Sants, 'Delivering intensive supervision and credible deterrence', CEO of the FSA, Speech at the Reuters Newsmakers event on 12 March 2009

[319] Waters (n 305); C Briault, 'More principles-based regulation and Treating Customers Fairly', Managing Director, Retail Markets of the FSA, Speech at the ASIC Summer School on 7 March 2007

[320] H Davies, Chairman of the FSA, Speech at CIMA's Sixth Anthony Howitt Lecture, 2 December 1999

The light-touch approach in the eyes of the FSA was a system of proportionate regulation given scarce economic resources.[321] The FSA resented this term 'light-touch',[322] but later under the new regulatory system, when the FSA was replaced with the Financial Conduct Authority it was recognised that there were many drawbacks in the light touch approach.[323] The role of the FSA according to this light-touch approach was largely to observe how the capital markets behaved, and the FSA would step in only if some of the observations indicated that without regulatory intervention they would not correct themselves. So, as it was discussed earlier the idea of minimal intervention stemmed from the assumptions of the efficient market hypothesis and the belief that financial markets would be able to organically stabilise themselves by moving towards an equilibrium.[324]

To be clear, such a light-touch approach was not without reasonable justifications. One of such justifications was the fear that strict regulations could potentially result in investors hurrying away to those financial centres with less cumbersome requirements.[325] Likewise, there was still a feeling of longstanding intimate relationship between the City and Westminster.[326] Back then, the Government knew that the City was mostly dealing with businesses unrelated to UK domestic market, that is, these businesses could be easily relocated.[327] All of these boiled down to the aspiration to maintain the City's competitive advantage, especially in times of an

[321] M Cole, 'The FSA's approach to insider dealing', Director of Enforcement, FSA, Speech at the American Bar Association, 4 October 2007

[322] C McCarthy, 'Financial regulation: myth and reality', Chairman, FSA, Speech at the British American Business London Insight Series ad Financial Services Forum, 13 February 2007

[323] A Bailey, CEO, FCA, 'The future of financial conduct regulation', Speech at Bloomberg, London, 23 April 2019

[324] E L Rubin, "Deregulation, Reregulation, and the Myth of the Market" (1988) 45 Washington and Lee Law Review 1249, 1257

[325] Gower Report (n 212) s. 1.15, see also C A E Goodhart, *The Central Bank and the Financial System*, (Springer, 1995), 443

[326] A Baker, 'Nebuleuse and the "Internationalisation of the State" in the UK? The Case of HM Treasury and the Bank of England', (1999) 6 Review of International Political Economy 79

[327] P D Culpepper and R Reinke, 'Structural Power and Bank bailouts in the UK and the U.S.', (2014) 42 Politics and Society 427

economic boom and later bubble of the mid-2000s.[328] Now, with the benefit of hindsight this competitiveness prevailed over long-term stability, because it would have been naïve to assume that that procyclicality would last forever.[329] The task to combat insider dealing was somewhat lost in this regulatory environment potentially giving rise to more insider dealing as a dearth of enforcement actions begot no deterrence.[330]

3.7.3. Risk-based approach

The risk-based approach grows out of Principle 1 of good regulations - the regulator should allocate its resources in the most efficient and economical way. There are two overarching ideas behind this approach, first, the scarcity of resources, and the FSA could not prevent all regulatory failures, e.g., all losses to consumers,[331] or prosecute and penalise every violation.[332] Consequently, it was accepted that some market failures were unavoidable,[333] even if such

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[328] I Begg, 'Regulation and supervision of financial intermediaries in the EU: The aftermath of the financial crisis' (2009) 47 Journal of Common Market Studies 1107

[329] S James and L Quaglia, 'Why does the UK have inconsistent preferences on financial regulation? The case of banking and capital markets', (2019) 39 Journal of Public Policy 177, 182

[330] Typically, in times of crisis and instability, illegal insider dealing is much more likely to occur in greater volumes then it would do under normal circumstances. For example, those banks who had greater exposure to the mortgage market experienced more instances of insider dealing, see O Akin, J Marin, and J L Peydro, 'Anticipating the Financial Crisis: Evidence from Insider Trading in Banks' (2016) CEPR Discussion Papers 11302; P Cziraki, 'Trading by bank insiders before and during the 2007-2008 financial crisis' (2018) 33 Journal of Financial Intermediation 58; or L A Bebchuk, A Cohen and H Spamann, 'Wages of failure: Executive compensation at Bear Stearns and Lehmann 2000-2008' (2010) 27 Yale Journal of Regulation 257; S Bhagat and B Bolton, 'Financial crisis and bank executive incentive compensation' (2014) 25 Journal of Corporate Finance 313

[331] FSA, Annual Report 2002/03, 96

[332] Cole (n 321)

[333] Speech of Sir C. McCarthy, Chairman of the FSA to the ASIC, on 'Risk-based Regulation: The FSA's Experience', 13 February 2006

failures were bad.[334] The risk-based approach justified minimal regulation and principles-based approach, in that if it was impossible to detect and act on every market setback let senior management carry this burden of detecting and grappling with risks with the FSA intervening only in cases of serious failures.[335]

The main issue with the risk-based approach was, and still is, pinning down and measuring risks within this non-zero failure regulatory attitude. The FSA used a risk assessment mechanism called ARROW (advanced risk-responsive operative framework),[336] which divided regulated firms in accordance with their potential impact on the statutory objectives.[337] ARROW was structured in a straightforward manner, the larger firms would be under constant supervision, whereas the medium-high firms would be regularly supervised, the medium-low firms would be sporadically visited by the FSA, and the small firms would only be statistically and thematically evaluated.[338] A significant risk to a statutory objective was defined as equalling the impact of the problem if it occurred multiplied by the probability of the problem occurring with the impact's classification laying on a four-point scale, low, medium, medium high and high.[339]

In relation to insider dealing, it is difficult using this measurement to proactively define the potential impact of insider dealing on the financial system. At that time, there were not benchmarks, such as, a strong track record of successful insider dealing cases against which this impact factor could be measured. Assuming that this impact factor was diminished investors' confidence in the UK financial system, that is, a tremendous impact, but yet again, the FSA did not spell out how it would gauge this confidence slump and ascribe it to insider dealing.

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[334] M Cole, Director of Enforcement, FSA, at the Annual Financial Crime Conference on 'Delivering Credible Deterrence', 27 April 2009; see also Speech at Fordham Law School, New York: The UK FSA: Nobody Does it Better?, 17 October 2006

[335] D Llewellyn, 'The economic rationale for financial regulation, (1999) FSA, London

[336] In 2006, the FSA updated ARROW by ARROW II

[337] The risks were measured against the statutory objectives, FSA, 'The FSA's regulation of professional firms', Consultation Paper 30, October 1999, para 11.2

[338] The FSA's Risk-Based Approach: A Guide for Non-Executive Directors, November 2006, 5

[339] Ibid

The probability of insider dealing occurring was likewise poorly defined. What is the probability of insider dealing? As it will be seen in chapter four, there are numerous detection mechanisms used for collecting intelligence for predicting such a probability of potential insider dealing. Likewise, firms failing to comply with High Principles are indicative of an increased probability of insider dealing. At the same time, it might have been the case that the FSA simply downplayed the insider dealing threat and did not pay attention to it as much as it should have done.[340] In fact, the Enforcement Division at the FSA was explicitly down in the pecking order accounting only for about five per cent of staffing back in 1999.[341] In 2006, the Enforcement Division's numbers rose by just about three percent.[342]

3.7.4. Credible deterrence approach

Sir McCarthy, the then Chairman of the FSA admitted that insider dealing was not taken seriously by market participants.[343] It was believed that the more aggressive imposition of criminal sanctions would change this behaviour.[344] This led to the introduction of the credible deterrence approach,[345] which engineered this transformation of the FSA from being a non-enforcer[346] to an enforcement-led regulator.[347]

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340 Akin and others (n 330)

341 Ibid

342 M Cole, The FSA's Market Abuse Strategy: Prevention and Cure', Director of Enforcement, FSA, Speech at the Securities House Compliance Officers Group, 29 June 2007

343 J Treanor, 'FSA presses for plea bargaining in crackdown on insider trading', (2008) the Guardian, 7 May, available at https://www.theguardian.com/business/2008/may/07/mergersandacquisitions, accessed 2 March 2023

344 Cole (n 334)

345 M Cole, 'Insider Dealing in the City', Director of Enforcement, FSA, Speech at the LSE, 17 March 2007

346 M Cole, The FSA's agenda for fighting financial crime', Director of Enforcement, FSA, Speech to the British Bankers Association, 19 November 2009

347 FSA, Annual Report 2008/09, 8

In this connection, let us turn to the first successful criminal case against McQuoid and his father-in-law in 2009.[348] The former individual was a solicitor who came into possession of price-sensitive information regarding a proposed takeover of TTP Communications Plc by Motorola Plc. He passed this information on to his father-in-law, who acquired rounded up 154,000 shares at 13p per share prior to the takeover announcement. After the announcement, the price tripled to 45p per share generating them a profit of around £50,000. The FSA was able to secure two convictions, McQuoid was sentenced to eight months in prison on trial at Southwark Crown Court of a single count of insider dealing, and his father-in-law to eight months suspended for twelve months.

It is interesting that, as opposed to the earlier civil cases, the defendants asked the Court to have their case considered under the civil regime as all the other previous cases were. The Court responded that,

> '…Those involved in the earlier investigations when a different policy was apparently adopted (and assuming that a different policy was adopted) may have been very fortunate.'.[349]

The Court further elaborated on the nature of insider dealing by stating that

> 'If there was a feeling that insider dealing was a matter to be covered by regulation, that impression should be rapidly dissipated…',

with the following striking message,

> '…Although those who perpetrate the offence may hope, if caught, to escape with regulatory proceedings, they can have no legitimate expectation of avoiding prosecution and sentence'.[350]

What these excerpts point out is that the enforcement of insider dealing regulations depends on the attitudes towards enforcement of insider dealing regulations. This case therefore shows that the Regulator in enforcing insider dealing regulations can ramp up the intensity of detection and amplify the severity of sanctions when need be. Another issue with this is that if the

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[348] *R v McQuoid* [2009] EWCA Crim 1301, 27 March 2009. It should be said that there had been three other criminal legal cases carried out by the DTI, the Serious Fraud Office and the Police, in 2003, 2004 and 2009

[349] Ibid

[350] Ibid

Regulator can twist the regimes as it finds effective, it puts the deterrent effects of both the regimes on an equal footing, that is, indeterminable, or at least ambiguous. Against that background therefore any civil case can be prosecuted under the criminal regime, and any criminal case can be initiated under the civil regime. This is not to say that one's deterrent effect is stronger than the other, because as it will be shown in chapter five, although there is a sensible expectation of the criminal law's deterrent effect significance, the civil regime's deterrent effect can be artificially raised to the level of the potential criminal deterrent effect.

The credible deterrence approach unveiled another interesting pattern. When the DTI operated prior to the introduction of the FSA, there was only a criminal regime. So, when the DTI enforced, it largely utilised financial penalties with fewer suspended sentences, and just one custodial sentence. The FSA prior to the introduction of the credible deterrence approach under the dual-regulatory framework used only the civil regime, but after the introduction of the credible deterrence approach the FSA predominantly turned to the criminal regime. Thus, the FSA, in the space of four years amassed a substantially greater number of convictions compared to the previous statistics. Therefore, the enforcement of insider dealing regulations solely depended on the FSA's attitude towards any given case.

However, the credible deterrence approach did not forego the application of the civil regime. The FSA carried out some well-known insider dealing cases under the civil regime, for example, against Ralph, the former UK ambassador to Romania and Peru. He was fined in the amount of £117,691.[351] Ralph was appointed Executive Chairman of Monterrico Metals Plc whose shares were quoted on the Alternative Investment Market (AIM), and he was actively involved in the takeover discussion for the company. He was accused of two counts of insider dealing, the dealing and unlawful disclosure of inside information to his friend Boyen, during the takeover period. 8,500 shares were bought at 236p per share and 3,850 at 262.25p per share, after the announcement the price rose to 350p per share generating a profit of £12,691. Boyen in the same vein raked in £29,482 from these transactions.[352]

[351] FSA, Final Notice to Richard Ralph, 12 November 2008, available at https://www.fca.org.uk/publication/final-notices/richard_ralph.pdf, accessed 18 February 2021

[352] FSA, Final Notice to Filip Boyen, 12 November 2008, available at https://www.fca.org.uk/publication/final-notices/filip_boyen.pdf, accessed 18 February 2021

In January of 2009, Clifton and Byron Holdings, were fined £59,500 and £86,030 respectively.[353] The former dealt in the shares of Desire Petroleum, an AIM-quoted company (he was a non-executive director). Clifton was also a shareholder of Byron Holdings which he instructed to buy shares in Desire based on inside information. The FSA viewed his conduct as particularly serious because,[354]

(1) He was in a position of trust as a director of Desire,

(2) He directed Byron to purchase shares in Desire on four separate occasions, without any point considering whether he was permitted to do so,

(3) The amount of profit made is substantial,

(4) Confidence in the AIM market could be damaged or put at risk.

The reason for this case being prosecuted under the civil regime can be put down to what the FSA ascertained that he did not realise, at any point during the relevant period, that he had inside information about Desire, his conduct was not deliberate, he did not conceal the dealings, and co-operated with the investigation.[355]

These civil cases show that the FSA enforced the dual regime inconsistently, meaning that almost every civil case could have been *promoted* to a criminal prosecution, and some criminal cases could have been *demoted* to a civil prosecution. The factors laid out by the court in the case of *McQuoid*, and the reasoning of the FSA demonstrate a relative flexibility of these thresholds, which could be moulded by the prosecutor depending on its concealed justifications.

3.8. Discussion and concluding remarks

This chapter attempted to answer question (c). The prohibition of insider dealing was anticipated to bring about a deterrent effect so that would-be insiders did not violate the law.

[353] FSA, Final Notice to Darwin Lewis Clifton OBE Byron Holdings Limited, 27 January 2009, available at https://www.fca.org.uk/publication/final-notices/darwin_clifton.pdf, accessed 17 February 2021

[354] Ibid, para 2.4

[355] Ibid, paras 2.5 and 4.10

Deterrence has therefore always been the underlying philosophical basis underpinning the prohibition of insider dealing. Falling under the broader scope of financial services regulations, deterrence was undermined by the overall approaches to financial regulations influenced by deregulation, or minimal regulatory intervention together with scarce economic resources, limited legal powers and improperly devised strategies to tackle insider dealing contradicted to the purpose of insider dealing regulations. Some of these challenges were rectified as insider dealing regulations evolved.

The FSMA 2000 bestowed the FSA with more statutory powers to enforce the law, including the introduction of civil sanctions against both individuals and legal persons. It was unclear how the regimes would interact in practice, but it was believed that the civil regime would complement the existing criminal regime by lowering the criminal law's burden of proof thereby slicing the length off investigations. Neither justification significantly ameliorated the challenges. It became evident from Section 3.7.4., that the FSA could effectively manoeuvre between the regimes in selecting which regime to be enforced. This evinced two facts. First, the enforcement of insider dealing regulations hinged on the attitudes towards insider dealing, which could be adjusted that is rectified. Second, there was little to no discussion on the severity of civil sanctions standing alone or/and in the presence of criminal sanctions.

The latter is essential because a deterrent effect from a criminal punishment is a function of the possibility of conviction, with any other concomitant administrative or disciplinary sanctions. Whereas a deterrent effect from a civil sanction is a function of a financial penalty, with other concomitant administrative or disciplinary sanctions, plus the quantified monetary benefits and other aggravating and mitigating factors. Calculating a deterrent effect from civil financial sanctions is therefore much more difficult because quantitatively speaking, a financial penalty should be greater than the quantified illegal gains, but accurately quantifying illegal gains from insider dealing is an arduous task. Given the argument in the Conclusion to chapter one that it is impossible to precisely estimate harm from insider dealing, and in view of the case against Einhorn, it is reasonable to theorise that any quantified illegal benefits from insider dealing are just approximations, even when the FSA can quantify the correct amount of illegal gains. The criminal regime is different because there is a possibility of a custodial sentence which could arguably cancel out the quantification issue as it will be further discussed in chapter five.

CHAPTER FOUR

The Financial Conduct Authority: Detection and Enforcement of the Civil Regime

This chapter will aim to answer questions (d), (e) and (f). Question (d) will be answered by analysing the notion of inside information and it will be elaborated on the argument that the FCA cannot, at least always, be certain as to the correct amount of quantified illegal gains from insider dealing. This argument will be built on and derived from the challenges associated with the identification of inside information, legality of insider dealing under certain circumstances as set out in multiple exemptions and defences provided for in UK MAR and the CJA 1993 and especially relevant to the criminal regime, is the knowledge of an insider that they in possession of inside information. Because a criminal investigation will come apart should an alleged insider prove that they were not aware of possessing inside information at the time of dealing, disclosing or encouraging another person to capitalise on that inside information. In civil cases this condition is dispensable.

In order to answer questions (e) and (f), this chapter will be constructed around two operations, detection and investigations on the one hand, and punishment on the other. Therefore, this chapter will aim to gradually integrate the deterrence theory's assumptions of certainty and severity of punishment with the discussion by treating the first operation as indicative of certainty and the latter operation of severity. Within the certainty criterion the following aspects will be addressed, the legal powers available to the FCA to detect and investigate civil and criminal insider dealing. Within the severity criterion this chapter will look into the civil regime's penalty-setting framework for any potential structural shortcomings.

4.1. Post-financial crisis of 2007/09 reforms

When the tide of the global financial crisis of 2007/09 went out, it laid bare the swathes of hidden shortcomings in the approaches to and structure of financial regulations. The light-touch approach to regulations, sporadic enforcement as it was discussed in the previous sections created an auspicious environment for financial crimes leaving the Government with no choice other than reconsidering the financial regulatory framework.[356] It is widely accepted in the existing academic literature that corporate crimes, such as, market manipulation, fraud, various Ponzi schemes, false accounting including insider dealing were conducive to the economic downturn.[357] This reconsideration of the regulatory framework led to the enactment of Part 2 of the Financial Services Act 2012 replacing the FSA with the FCA. The legal structure of the FCA has remained similar to that of the FSA, a company limited by guarantee accountable to HM Treasury and funded entirely by fees collected from the firms it regulates.[358] However, some of the responsibilities were taken away from the FCA[359] and given the Prudential Regulation Authority, which is responsible for micro-prudential regulation,[360] and the Financial Policy Committee, which is not a regulator *per se*, but it performs an important function of carrying out macro-prudential regulation.[361]

At the same time, the EU Commission was churning out Directives and Regulations to expand the scope of market abuse regulations so as to provide national authorities with a greater set of powers, impose stricter requirements on market participants and expand the scope of market abuse. The Markets in Financial Instruments Directive (UK MiFID II), which came into effect in January 2018, together with the Regulation[362] and European Market Infrastructure

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[356] N Ryder, *Financial Crisis and White-Collar Crime: the Perfect Storm?*, (Edward Elgar, 2014), Chapter 5. See also, Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Financial Crisis Inquiry Commission: Washington D.C., 2011), 14, 160, and 164 with respect to insider dealing. R Tomasic, 'The financial crisis and the haphazard pursuit of financial crime' (2011) 18 Journal of Financial Crime 7, 10. Podgor also refers to the facts that insider dealing may have played a consequential role in the global financial crisis of 2007/09, in E S Podgor, 'White-collar crime and the recession: was the chicken or egg first?' (2010) University of Chicago Legal Forum 205. HM Treasury, Working Paper 'A new approach to financial regulation: the blueprint for reform', June 2011, Cmnd 8083, generally puts it as '…a lack of systemic oversight and effective tools for the regulators', 15

[357] Ibid

[358] Approach to enforcement (n 2)

[359] See for other tasks of the FCA, FCA, Perimeter Report 2019/2020

[360] Part 2, FSMA 2000. Both these two regulators are accountable to the Bank of England

[361] Section 9B FSMA 2000

[362] Regulation 2014/600EU on markets in financial instruments and amending Regulation (EU) 648/2012

Regulation,[363] and the new Market Abuse Regulation[364] (UK MAR) reshuffled the financial services' landscape casting the net far and wide to haul in new financial instruments, behaviours, practices and trading venues. At the time of submitting this thesis, all these EU Regulations and Directives are still in force in the UK by virtue of the Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018, and the European Union (Withdrawal) Act 2018. But it should be put emphasised that the newly enacted Financial Services and Markets Bill 2022 will repeal retained EU law piecemeal and supplant it with UK-specific legislation, which is yet to be announced. So, it is unclear whether for example the text of the UK MAR provisions relating to insider dealing will remain as part of the UK legal system or new amended UK-specific legislation's wording be similar to that of UK MAR.

It would be impossible in this thesis to outline all the changes brought in by these new pieces of legislation, so only those changes concerning insider dealing will be highlighted,

(1) The setting down of rules on pre-trade and post-trade market transparency requirements,[365] and the expansion of reporting and disclosure obligations imposed on regulated persons and persons discharging managerial responsibilities.

(2) The scope of financial instruments to be regulated was significantly extended to covering equity-like and non-equity financial instruments.[366]

(3) The requirements imposed on firms/persons to install and maintain adequate internal systems and controls to detect market abuse, given the technology advancements in algorithmic trading

(4) The introduction of the small and medium enterprises growth market (hereinafter SME GM) regime under Article 33 UK MiFID II.[367]

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[363] Regulation 648/2012 lays down rules on OTC derivatives, central counterparties (CCP), and trade repositories

[364] Regulation (EU) No 596/2014 on market abuse. This Regulation comprises Chapter X of Regulation (EU) No 1031/2010 concerning market abuse in emission allowances

[365] Article 26 UK MiFIR

[366] For example, equity-like instruments are, exchange traded funds (ETFs) or depositary receipts, and non-equity instruments are, bonds, structured finance products (e.g. collateralised debt obligations), derivatives (e.g. futures, options, various types of swaps) and emission allowances

[367] Recital 132 UK MiFID II

4.2. Objectives of the FCA

Section 1B FSMA 2000 sets out the strategic and operational objectives of the FCA. The former objectives require the FCA to ensure that the relevant markets function well, and the operational objectives are, (a) consumer protection, (b) integrity of the UK financial system, and (c) promoting effective competition.[368] As it was in the case with the FSA, the FCA also must comply with the principles of good regulation,[369] and deploy the risk-based approach,[370] and firms must comply with the Principles for good business as set out in PRIN 2.1.1[R] and touched upon in chapter three. The Financial Services and Markets Act 2022 introduced a secondary objective to facilitate the international competitiveness of the UK economy. This thesis will not dwell on this objective as it falls outside the scope of the examination, but a note must be given that in 2019, the FCA was not particularly welcoming of this new objective.[371]

The implementation of insider dealing regulations falls within the scope of section 1D FSMA 2000 setting down the integrity objective, which is defined as (a) the soundness, stability and resilience of the UK financial system, (b) the UK financial system is not being used for a purpose connected with financial crime, (c) the UK financial system is not being affected by insider dealing and market manipulation, (d) the orderly operation of the financial markets, and (e) the transparency of the price formation process in those markets.

The FCA implements these objectives are implemented through the following processes,

Authorisation. Only those firms or individuals who meet the FCA’s minimum standards may carry on regulated activities in the UK,[372]

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[368] This objective is shared with the Competition and Markets Authority, implies keeping markets open to innovation and maintaining consumer choice

[369] FCA, Principles of good regulation, available at https://www.fca.org.uk/about/principles-good-regulation, accessed 20 October 2022

[370] SUP 1A.3.2A[G]

[371] A Bailey, CEO, FCA, 'The future of financial conduct regulation', Speech at Bloomberg, London, 23 April 2019

[372] FCA Mission: Our Approach to Authorisation, November 2018. The list of regulated activities can be found in Sch. 2 FSMA, and the Regulated Activities Order 2001. The regulated activity is defined in s. 22 FSMA 2000

Supervision. To ascertain whether those authorised persons comply with the requirements,

Enforcement. To enforce regulations when a person fails to comply with the requirements,

International co-operation. Information sharing is vital in detecting and prosecuting financial crimes.

While the objectives of financial regulations were not significantly altered, it is the ways of delivering these objectives that have been approached differently. This thesis will focus on the enforcement aspect as set out in section 402 FSMA 2000. A brief note will be given to supervision as it overlaps with the purposes of enforcement policies.

4.3. Supervision and senior managers and certification regime

For as long as an authorised person carries on regulated activities, the FCA monitors and supervises this person compliance with insider dealing regulations in accordance with section 1L FSMA 2000. The general principles of supervision are the following,[373]

(1) Forward-looking,

(2) Focusing on strategy and business models,

(3) Focusing on culture and governance,

(4) Focusing on individual as well as firm accountability,

(5) Supervision is proportionate and risk-based,

(6) Two-way communication between the FCA and a firm,

(7) Co-ordination, liaising with other agencies,[374]

(8) Removing systemic harm and stop it happening again.

These principles are incorporated into the FCA's model of supervision consisting of three pillars empowering the FCA to prevent problems crystallising,[375]

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[373] SUP 1A.3.2A[G]

[374] SUP 1A.3.8[G]

[375] SUP 1.A.3.1[G] and 1.A.3.4[G]; The FCA, Annual Report and Accounts for 2015/16, 11

(1) Proactive firm supervision: pre-emptive identification of harm through review and assessment of firms and portfolios,

(2) Reactive event-driven supervision: if harm has already taken place to take measures to stamp it out and prevent it growing,

(3) Thematic: wider diagnostic or remedy work.

This supervision framework applies to all authorised persons, but the application varies. The ARROW risk management framework of the late FSA was abolished. Today there are two types of portfolios for the purposes of FCA's supervision, flexible and fixed. The former group typically affects SMEs and is supervised through thematic-based work, communication and education. The latter group typically affects large firms and is supervised by an appointed supervisor team with them.[376]

Keeping in line with the risk-based approach, the FCA allocates its resources relying on the following risk management formula,[377]

$$\text{Risk for the FCA} = \text{Impact of the problem if it occurs} \times \text{probability of the problem occurring}$$

In a similar fashion to the late FSA, in cases of insider dealing it is difficult to calculate both the potential impact and its probability of occurring, simply because insider dealing can range from no profit at all to millions of pounds having a considerably heterogenous impact on the integrity. Hence, it cannot instantaneously be multiplied by the probability of insider dealing occurring. Without so much as numerically assigning a value to this probability, this thesis building on the difficulties quantifying harm from insider dealing will argue that the risk of insider dealing is constant, but the actual likelihood of a particular insider dealing act is scarcely possible to situate. Unlike the FCA, firms do know, or at least it is expected of them to know that probability. Normally, they are the creators or co-creators of price-sensitive inside information. For example, firms negotiating a merger ought to realise that this information is potentially price-sensitive, hence the probability of insider dealing is increased. Therefore, the aforementioned risk management formula can be effective if the FCA wields adequate legal

[376] SUP 1A.3.3[G]. The firms in the fixed portfolio are much larger than those in the flexible portfolio, hence they represent stronger market presence and consumer impact

[377] FCA, Risk management, 21 September 2017, available at https://www.fca.org.uk/about/supervision/risk-management, accessed 5 March 2021

powers to enforce the law and firms ensure that their internal systems and controls are properly installed, run and maintained.

Senior managers, performing a senior management function (hereinafter an SMF), who are pre-approved by the FCA,[378] should act in such a way so that the integrity objective is not compromised but protected.[379] One of the main prerequisites to being approved, is to pass a fit and proper test with all their responsibilities to be clearly set out in a statement of responsibilities. Pursuant to FIT 1.2.1B[G], under sections 60A and 63F FSMA 2000, in assessing whether a person is a fit and proper person to perform an FCA designated SMF or an FCA certification function,[380] a firm must have particular regard to whether that person,

(1) has obtained a qualification, or

(2) has undergone, or is undergoing, training, or

(3) possesses a level of competence, or

(4) has fitting personal characteristics, as for example under FIT 1.3.1B[G].[381]

As an aside, London Capital & Finance (hereinafter LCF), a financial services firm squandered more than £200 million of retail investments through promoting and selling

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[378] FCA, The Senior Managers and Certification Regime: Guide for the FCA solo-regulated firms, July 2019. See also House of Lords and House of Commons, *Changing banking for good*, Report of the Parliamentary Commission on Banking Standards, Volume II: Chapters 1 to 11 and Annexes, together with formal minutes, HL Paper 27-II, HC 175-II, June 2013

[379] Section 59ZA FSMA 2000. There are two tiers of conduct rules, where the first tier applies to most employees, and the second tier applies only to senior managers. These rules apply in two situations, to activities carried out from the UK, and to activities carried out from outside the UK, but only if the activity involves having contact with UK clients. That is to say, if a person based overseas does not deal with a UK client, the Conduct Rules will not apply to him. These rules are also subject to limited scope firms, core firms and enhanced firms. For example, CASS firms. CASS 1A.2.7[R] A large firm whose highest total amount of client money is or was more than £1 billion. Limited scope firms are subject to a fewer requirements, those firms who are not UK MiFID investment firms, and who are sole traders, or oil market participants and the like, and they make up most of the regulated firms

[380] The certification regime is not an SMF, hence it is not required prior authorisation, but such employees should still be fit for a job

[381] In the FCA's view, the most important considerations will be the person's honesty, integrity and reputation, competence and capability, and financial soundness.

unregulated mini-bonds promising unrealistic hence misleading returns of up to 8 per cent.[382] Following this scandal, HM Treasury initiated an independent investigation into the collapse of LCF. In the Final Report[383] it is stressed that the senior management of the FCA was aware of these risks but did nothing to remedy them[384] and recommended that the FCA be more proactive and decisive in supervising and acting on potential fraud. Detecting and enforcing insider dealing regulations as it will be shown below likewise depends on the timely actions of the FCA, but it is not always the case.

4.4. Detection

Some of pre and post-trade requirements are designed for investors to be able to make weighted investment decisions, whereas others, such as transaction reporting, reports submitted by persons discharging managerial responsibilities (hereinafter PDMRs), suspicious transactions and orders reporting (hereinafter STORs), whistleblowing, market cleanliness statistics, and other forms of intelligence, are specifically used by the FCA in detecting insider dealing.[385] Owing to these powers the FCA should and can alleviate the challenges to enforcement.

4.4.1. Pre-trade transparency requirements

The pre-trade transparency requirements can be split into two processes undertaken by the authorised person, (1) the admission of securities to trading,[386] and (2) publication of quotes

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[382] T Kinder, 'Thirteen sued for £178m over alleged fraud at London Capital & Finance', (2020) Financial Times London 4 September, available at https://www.ft.com/content/93dd8947-3188-4510-adbc-95b1c1549eb6

[383] Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc 23 November 2020

[384] Ibid 293

[385] SUP 1A.4.5[G], see also FCA Mission: Approach to Supervision, April 2019

[386] All trading venues and SIs must submit their reference data regarding all financial instruments being traded (or to be traded) to the FCA. The term financial instrument refers to a financial instrument specified in Section C of Annex I to MiFID II

on a capital market.[387] It needs saying that these requirements' objective is to allow investors to have relevant information prior to making an investment decision, that is, the requirements are designed for maintaining the efficiency of capital markets, for example, fostering the price formation process. Therefore, these pre-trade requirements are to a lesser extent facilitate the detection of insider dealing.

The London Stock Exchange has stringent requirements for firms wishing to float.[388] On the other hand, the Alternative Investment Market (hereinafter AIM), which is an SME growth market[389] imposes much less onerous requirements upon its members.[390] With respect to the publication of quotes on a trading venue, this requirement implies that market operators and investment firms operating a trading venue shall make public current bid and offer prices and the depth of trading interests at those prices. This information is of course calibrated for different types of trading systems, such as, order-book, for example, SETS (Stock Exchange Electronic Trading Service) of the Exchange,[391] or quote-driven,[392] or hybrid.[393]

According to article 4 UK MiFIR there are four pre-trade transparency waivers, such as Large in Scale waiver (LSW), Reference Price waiver (RPW), Negotiated Transaction

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[387] Articles 7, 10, 12, 13, 20 and 21 MiFIR, and Article 65 MiFID II (on organisational requirements) for Consolidated Tape Providers, an authorised person to collect trade reports for financial instruments from RMs, MTFs and OTFs, consolidating them into a continuous e-live data stream providing price and volume data per financial instrument

[388] See the Listing Regime and Obligations on the LSE

[389] The SME GM regime was introduced with MiFID II to cajole SMEs into accessing equity and debt financing

[390] To be listed on AIM, firms are not expected to sustain a minimum size, have a trading history, free float and so on, Articles 7, 15, 18, Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC provide for the EU Growth Prospectus regime, which enables a firm to provide only material and relevant information, including risk factors. Although article 1 provides for multiple exemptions to the prospectuses in general. Another distinctive feature of AIM is that the bulk of supervision is outsourced to nominated advisers (NOMADs), which are the firms authorised by the FCA to guide SMEs throughout their pre- and post-admission on AIM, with the FCA enforcing market abuse regulations.

[391] Brokers submit bid and offer prices on behalf of their clients until they are matched

[392] Market makers set bid and ask prices

[393] SETSqx for less liquid securities traded on AIM

waiver (NTW), and Order Management System waiver (OMSW).[394] The first two waivers are specifically used by alternative trading systems (such as dark pools, for example, Turquoise order books) to get round the double volume cap,[395] in which large institutional investors can execute large orders anonymously through an uninformed order flow.[396] In other words, investors on lit order books, i.e. on a pre-trade transparent capital market such as the London Stock Exchange, do not know of these trades until after they have been executed and reported to the market. By enforcing these requirements, one might expect that a listed firm has undergone all the necessary checks, and that the pre-trade transparency waivers do not impair price discovery. At this point in time, one does not know whether these prices have not been tampered with by insider dealing, but it could become known owing to the post-trade trade transparency requirements.

4.4.2. Post-trade transparency requirements

With the pre-trade transparency requirements ensuring that investors are on an equal footing, the post-trade transparency requirements were explicitly designed for detecting market abuse. Post-trade transparency requirements can be further divided into trade reporting and transaction

[394] For specific examples of these waivers see ESMA, ‘Waivers from pre-trade transparency’ CESR positions and ESMA opinions, 20 June 2016, ESMA/2011/241h, available at https://www.esma.europa.eu/sites/default/files/library/2011-241h_esma_opinions_cesr_positions_on_pre-trade_waivers_0.pdf, accessed 19 December 2020

[395] Article 5 UK MiFIR. The FCA decided not to apply the double volume cap to all equities, FCA, 'Suspending the use of pre-trade transparency waivers for a trading venue for the purposes of the double volume cap under article 5(3B) UK MiFIR', 4 March 2021. See C Neumeier, A Gozluklu, P Hoffman, P O'Neill and F Suntheim, 'Banning dark pools: venue selection ad investor trading costs' (2021) FCA Occasional Paper 60

[396] It simply means that other investors are not able to see these bids and orders, but after these orders have been executed, they are disclosed to the market(s). UK MiFID II imposes a volume cap with the double volume cap put on all equity instruments (unless it concerns illiquid financial markets). This is done to limit execution of transactions in dark pools, currently the limit are set at 4% at a trading venue, and 8% for all EU trading venues, article 5 MiFIR. For further information see ESMA, MiFID II/MiFIR Review Report on ‘the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares’ (2020) ESMA70-156-2682

reporting, so that each and every trade and transaction executed on a trading venue or systematic internaliser is disclosed to the general public and the FCA respectively.[397]

4.4.2.(i) Transaction reporting

Transaction reporting's only purpose is to feed the FCA with information as regards all transactions carried out by an authorised person. A transaction according to Article 2 RTS 22 is the conclusion of an acquisition or disposal of a financial instrument, and the execution of a transaction is according to Article 3 RTS 22 is,[398]

(a) Reception and transmission of orders in relation to one or more financial instruments. For example, transmission of redemption orders from a client to the operator of a collective investment undertaking (CIU) (i.e. an investment fund), or buy-sell orders to agency brokers,[399]

(b) Execution of orders on behalf of clients,

(c) Dealing on own account,

(d) Making an investment decision in accordance with a discretionary mandate given by a client,

(e) Transfer of financial instruments to or from accounts.

Each of the aforementioned conditions requires a transaction report to be given in to the FCA including a number of parameters, some of them are,[400]

[397] Article 23 UK MiFIR. Unless a trade is undertaken outside a trading venue in situations set out in Article 2 RTS 1, which are ad hoc/irregular, between professional/eligible counterparties and these trades do not contribute to the price formation process, for example, transactions executed by reference e.g. a volume-weighted or time-weighted average price, is part of a portfolio trade, is a give-up or give-in transaction and so forth

[398] Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing Regulation (EU) No 600/2014 with regard to regulatory technical standards for the reporting of transactions to competent authorities

[399] Transmission of an order as defined by Article 4 RTS 22 for the purposes of Article 26(4) MiFIR

[400] For the full list see Table 2 RTS 22

(a) ISO 17442,[401]

(b) ISO 3166-1 alpha 2,[402]

(c) ISIN, an international securities identification number,

(d) ISO 10962,[403]

(e) Market Identifier Code (MIC),

(f) An assigned transaction reference number (TRN) to each transaction executed,

(g) Short-sale transaction if any[404]

(h) Identification of a person/computer algorithm responsible for the investment decision and execution.[405]

Thus, the FCA is expected to receive all necessary information in relation to all transactions to track, record and analyse the incoming data. Once a transaction report has been written up it is transferred to an Authorised Reporting Mechanism (ARM),[406] for example, MarketAxess Post-Trade Limited, or through the trading venue, where the transaction(s) has taken place, and then

[401] Article 5 RTS 22, an investment firm legal identifier

[402] Ibid, Article 6. The International Standard for country codes and codes for their subdivisions, for further information see ISO at https://www.iso.org/home.html

[403] Classification of financial instruments

[404] Article 11 RTS 22

[405] Ibid, Articles 8 and 9

[406] Approved Reporting Mechanism (ARM) is a legal entity authorised to report transactions to the FCA on behalf of investment firms, see the Commission Delegated Regulation (EU) 2017/571 of 2 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the authorisation, organisational requirements and the publication of transactions for data reporting services providers. A transaction report should indicate the status of this report as set out in Article 4(1)(6) and (38) MiFID II

this report is passed on to the FCA in T+1.[407] The more accurate data are submitted by firms,[408] the higher the probability of uncovering illegal conduct.

At the same time, it is a demanding process that can perplex firms recording hundreds of thousands (even millions) of transactions a day, and lead to inaccurate or erroneous submissions, as it was in the case of Goldman Sachs International (GSI). In 2019, GSI was fined £34.3 million for transaction reporting failures between November 2007 and March 2017, where the bank failed to provide accurate and timely information in relation to approximately 213.6 million reportable transactions, in which were 220.2 million errors.[409] Moreover, in recent research conducted by ACA Group, a governance, risk and compliance advisor in financial services, it was found persistent and significant problems in transaction reports, where 97 per cent of reports contain inaccuracies. This research also shows that many investment firms do not refine the quality of transaction reports. As a consequence, these problems undermine the ability of the FCA to protect and maintain the integrity objective.[410] The FCA has announced that there will be some amendments to the transaction reporting requirements in 2024, at the time of submitting this thesis it is yet unclear what these changes will be.[411]

4.5. Requirements under UK MAR

Below the following detection tools will be discussed, insider lists, suspicious transactions and orders reports, reports to be submitted by persons discharging managerial responsibilities and public disclosure of inside information.

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[407] Article 26 UK MiFIR, there is an obligation to maintain records for five years. T+1 means a trade to be reported at the latest the day after the execution. Deutsche Börse, Market Axess, Frequently Asked Questions, Version 6.1, 26 April 2023

[408] FCA, Market Watch 63, May 2020

[409] FCA Final Sanction Notice of 27 March 2019, Reference Number 142888. The FCA also fined UBS AG £27.6 for similar transaction reporting errors, FCA Final Sanction Notice of 18 March 2019, Reference Number 186958

[410] C Longman, 'UK MiFIR transaction reporting: fundamental, crucial, a common good - but typically wrong', (2022) 6 Journal of Financial Compliance 129

[411] FCA Policy Statement (n 51)

4.5.1. Insider lists

Article 18 UK MAR and Regulation (EU) 2016/347 of 10 March 2016,[412] as incorporated into UK law under the European Union (Withdrawal) Act 2018, require issuers and emission allowance market participants (hereinafter EAMPs), or any other persons acting on their behalf to draw up insider lists and keep them up to date.[413] Firms listed on a SME growth market, do not have to maintain such lists, but they must provide it to the FCA upon request.[414] This requirement might come across as straightforward to implement, but in reality, it is difficult to comply with.

To illustrate the importance and complexities of this requirement consider the following case. In December 2020, the Court of Appeal upheld the convictions handed down by Southwark Crown Court against Abdel-Malek and Choucair.[415] The former was a senior compliance officer at UBS AG, who repeatedly abused her position by accessing inside information pertaining to the five merger and acquisition transactions on UBS AG compliance systems to which she did not have any need to access. Abdel-Malek then passed it along to her friend Choucair, who later traded in those shares generating a profit of around £1.4 million. Abdel-Malek was not on the insider list kept by the bank, but she could regularly access confidential information without being prevented.

This case shows that incorrectly composed/updated insider lists can lead internal systems and controls being obviated. However, even having up-to-the-minute insider lists cannot straighten out a situation where for example an insider list contains hundreds of names entitled to access inside information.[416] Therefore, it is essential in the opinion of the FCA that

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[412] laying down implementing technical standards with regard to the precise format of insider lists ad for updating insider lists in accordance with Regulation (EU) 596/2014

[413] Commission Implementing Regulation (EU) 2016/347 of 10 March 2016 laying down implementing technical standards with regard to the precise format of insider lists and for updating insider lists in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council

[414] Ibid article 3

[415] *R (FCA) v Abdel-Malek and Anor* [2020] EWCA Crim 1730

[416] Ibid

firms develop a need-to-know policy,[417] with appropriate recording of every log-in into a system containing inside information. In Market Watch 60 and 71, the FCA observes that firms have enhanced monitoring of access to inside information by introducing new register systems to reduce the number of permanent insiders.[418]

4.5.2. Suspicious transactions and orders reporting

For the FCA, suspicious transactions and orders reporting (STORs) is a critical source of intelligence in identifying possible insider dealing.[419] In 2009, the FSA penalised Lockwood £20,000, for failing to observe proper standards of market conduct.[420] Lockwood,

> 'Failed to identify that a transaction was being conducted on the basis of inside information, despite being in receipt of clear warning signals, and, as a consequence, failed to prevent the trade or alert the retail stockbroking firm to the possibility that the trade was being conducted on the basis of inside information, sought to limit the extent to which the customer explained the basis for his trade'.[421]

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[417] FCA, Market Watch No 60, August 2019

[418] FCA, Market Watch 71, December 2022

[419] FCA, Final Notice, 208159, 25 January 2018. Article 16 UK MAR. For example, a sell or limit order, see Article 5 Commission Delegated Regulation (EU) 2016/957 of 9 March 2016 Supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions. Commission Delegated Regulation (EU) 2016/957 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions, as amended by FCA 2019/45, Annex F

[420] FSA, Final Notice, MXL01331, 1 September 2009

[421] Ibid, para 2.2.1, 2.2.2, and 2.2.3

In 2011, the FSA penalised Agnew £65,000, who performed the customer function[422] at JP Morgan Cazenove Limited, that is, was giving advice on, dealing and arranging deals in and managing investments,[423] for failing to exercise due skill, care and diligence in breach of High Principle 2.[424]

In 2016, there were 1,526 STORs received in relation to insider dealing, in 2017 the number tripled to 4,829 STORs, in 2018, the number of STORs rose to 5,107, in 2019, the FCA received 4,623 STORs, in 2020, the number went down to 3,553 STORs, in 2021, there were 4,233 STORs, and in 2022, the FCA was passed on to 3,367 STORs.[425] To supply such intelligence to the FCA, firms are required to maintain high quality internal systems and controls which allow for the analysis, individually and comparatively, of each and every transaction executed, and order placed, modified, cancelled or rejected in the systems of the trading venue (and outside), and produce alerts flagging up activities requiring further analyses.[426] Firms have been penalised for failing to comply with SUP 15.10.4[G] and Principle 3, we shall come to this later in the chapter.

The Achilles heel of a STOR and its limited application can be seen in the practice of algorithmic trading (hereinafter AT), especially with respect to contracts for difference and spread bets. AT is the process in which orders and/or quotes are entered, modified and cancelled by pre-figured algorithms leading to the conduct of trade with minimal, or even without human intervention.[427] Even though, firms engaging in AT are required under UK MiFID and UK MAR to possess resilient and sufficient capacity lest they are used for the purpose of market abuse,[428] the STOR mechanism can be futile. High frequency trading

422 SUP 10A.10.7[G] sets out what the customer function is

423 SUP 10A.10.3[G]

424 FSA, Final Notice, CJA10049, 3 October 2011

425 See FCA, Number of STORs received: 2022, available at https://www.fca.org.uk/markets/how-report-suspected-market-abuse-firm-or-trading-venue/number-stors-received-2022, accessed 7 August 2023

426 Ibid, Article 3. SUP 15.10.4[G]

427 Article 18 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing MiFID II as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

428 MAR 7A.3. It should be noted that, not all AT falls under these requirements, Automated Order Routing, the algorithms used only for choosing a trading venue are not AT, but Smart Order Routers which are used for

(hereinafter HFT) is a type of AT, in which traders can exploit price differences at less than a millisecond (i.e. 10^{-3} of a second) range[429] through either co-location,[430] or direct electronic access (hereinafter DEA).[431]

A DEA provider, who provides its trading ID to a client, can observe and terminate in real-time the orders/quotes made by its client, if it is provided through direct market access, otherwise under sponsored access, as the client goes around the DEA provider's infrastructure that is, directly deals with the trading venue, the DEA provider cannot observe its clients orders, but is still responsible for ensuring that its clients do not commit market abuse.[432] The DEA client can further sub-delegate the access rights onto a third party, called Tier-2 DEA, but who does not hold the trading code. Therefore, a DEA provider must be capable of maintaining the proper standards to be complied with their clients, and of course, if they fall short of the required standards, or their client's technology is superior to that of the DEA provider it will require the latter to spend more to catch up.[433]

investment decision optimisation/order execution are regulated, Recital 5 Commission Delegated Regulation (EU) 2017/589 of 19 July 2016 supplementing MiFID II with regard to regulatory technical standard specifying the organisational requirements of investment firms engaged in algorithmic trading, RTS 6

[429] It is expected that in the near future it will be possible to execute orders within a mind-boggling picosecond, which is one trillionth of a second. Today, according to Article 19 Regulation (EU) 2017/565, HFT should be (a) at least 2 messages per second with respect to any single financial instrument on a trading venue, or (b) at least 4 messages per second with respect to all financial instruments traded on a trading venue

[430] It is also called proximity hosting, that is, a firm engaging in HFT sets up their computers in the same place where the market stores its matching engine

[431] Article 4 (39) UK MiFID II. DEA is an arrangement where a member/participant/client of a trading venue permits a third person to use its trading code, so that person can electronically transmit orders relating to a financial instrument directly to a trading venue (including using the infrastructure of the DEA provider, called direct market access (DMA), or without if the person is provided with sponsored access (SA)).

[432] Recital 13 RTS 6. Article 21 RTS 6 specifies the requirements for the systems of DEA providers, and Article 13 RTS 16 requires DEA providers to install automated surveillance systems to detect market manipulation

[433] FCA, Regulating high-frequency trading, 4 June 2014, available at https://www.fca.org.uk/news/speeches/regulating-high-frequency-trading, accessed on 10 October 2020

The dangers of HFT are mainly concentrated in market manipulation practices, but of course it can be used for insider dealing purposes too.[434] For example, a strategy of an exchange-traded fund (ETF), which tracks an underlying index or security could be, it mirrors this asset movements at specific periods of time during the trading day and goes against such an asset movements as an inverse ETF within a short period only if certain conditions are met, say the underlying value has dropped below a pre-set level. These algorithms or strategies are inside information for the purposes of the CJA 1993.

4.5.3. Persons discharging managerial responsibilities

The last requirement under UK MAR is under article 19(2) which obliges persons discharging managerial responsibilities (PDMRs) and persons closely associated with them, to notify the issuer, and then the FCA, of every transaction conducted on their own account relating to the shares or debt instruments of that issuer or to derivatives or other financial instruments linked thereto.[435] A report must be made no later than three business days after the date of the transaction.[436]

Further requirements are imposed on PDMRs by Article 19(11) UK MAR, that is, they are proscribed from conducting any transaction on their own account or for the account of a third party, directly or indirectly, relating to the shares or debt instruments of the issuer or to derivatives or other financial instruments linked to them during a closed period of 30 calendar days before the announcement of an interim financial report or a year-end report which the

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[434] See for example, SEC to the Joint Advisory Committee on Emerging Regulatory Issues, Findings Regarding the Market Events of May 6, 2010, September 30, 2010, on the flash crash

[435] Article 10 Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council, sets out notifiable transactions, such as (a) acquisition, disposal, short sale, subscription or exchange, (c) entering into or exercise of equity swaps, or (j) automatic or non-automatic conversion of a financial instrument into another instrument, including the exchange of convertible bonds or shares, or (k) gifts and donations made or received, and inheritance received and so on

[436] This requirement is triggered when the total amount of transactions has reached the threshold of EUR 5,000 in a calendar year (convertible to GBP) and any subsequent transactions

issuer is obliged to make public. However, Article 7 Regulation 2016/522,[437] provides for permitted trading during a closed period provided that the conditions of Article 19(12) UK MAR are met,[438] and that the PDMR can demonstrate that the particular transaction cannot be executed at another moment in time than during the closed period.[439]

4.5.4. Public disclosure of inside information

Two arguments are raised by accounting research to justify disclosure regulations.[440] First, public disclosure improves economic efficiency by minimising market imperfections and externalities. Second, public disclosure reduces the information gap between informed and uninformed investors.[441] Prior to making an investment decision, investors must be furnished with relevant information in relation to the firm(s) concerned.[442] Therefore, issuers and

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[437] Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions

[438] Upon written request, on a case-by-case basis to the existence of exceptional circumstances, such as severe financial difficulty, and due to the characteristics of the trading involved for transactions made under, or related to, an employee share or saving scheme and so on

[439] Article 9 Regulation 2016/522 sets out the characteristics of the trading during a closed period, e.g. (a) a PDMRs had been awarded or granted financial instruments under an employee scheme, provided that the following conditions are met, (i) the employee scheme and its terms have been previously approved by the issuer, and the terms of the employee scheme specify the timing of the award or the grant, or the basis on which such an amount is calculated and given that no discretion can be exercised, and (ii) the PDMRs does not have any discretion as to the acceptance of the financial instruments awarded or granted

[440] P M Healy and K G Palepu, 'Information asymmetry, corporate disclosure, and the capital markets: a review of the empirical disclosure literature' (2001) 31 Journal of Accounting and Economics 405

[441] M K Jardak and H Matoussi, 'The effectiveness of insider trading disclosure policies: US and EU comparison' (2020) 18 Journal of Financial Reporting and Accounting 591

[442] Commission Implementing Regulation (EU) 2016/1055 of 29 June 2016 laying down implementing technical standards with regard to the technical means for appropriate public disclosure of inside information and for delaying the public disclosure of inside information in accordance with Regulation (EU) No 596/2014 of the

emission allowance market participants (hereinafter the EAMPs) must disclose any existing valuable information to as wide a public as possible on a non-discriminatory basis and free of charge.[443]

Public disclosure is usually conducted via the Regulatory Information Service, which must be notified as soon as possible after a firm has identified valuable inside information.[444] Under certain circumstances an issuer and EAMP can on their own responsibility delay public disclosure of inside information by informing the FCA in writing of a delay in the disclosure.[445] The issuer and EAMP shall keep appropriate records for a written explanation, provided that all of the following conditions are met,

(a) immediate disclosure is likely to prejudice the legitimate interests of the issuer or EAMP,[446]

(d) delay of public disclosure is not likely to mislead the public,

(c) the issuer or EAMP is able to ensure the confidentiality of that information.[447]

European Parliament and of the Council. M Yontef, 'insider trading' in proposals for a securities market law for Canada, vol 3 Background papers, Minister of Supply and Services, Canada (1979), 625, 631

443 Ibid, Recital 1. Recital 46 UK MAR. DTR 2.2.4[G]. DTR 2.2.6[G] provides for the reasonable investor test in assessing whether inside information should be public disclosed, e.g. the assets and liabilities of the issuer, the financial condition of the issuer, the course of the issuer's business, or major new developments in the business of the issuer. See also CJA 1993 conditions for public information discussed in Chapter II. Article 2 Regulation) 2016/1055 of 29 June 2016

444 Article 2 (1)(a) and Article 3 Regulation 2016/1055 further Articles 17(1) and (9) UK MAR that such disclosed information must be put out on a firm's website (free of charge)

445 Under EU MAR, SMEs are exempt from having to keep records, or explain the reasons for delaying, only upon request from a competent authority. Article 5 Regulation 2016/1055 provides for delaying the disclosure of inside information for credit (financial) institutions with a view to preserving the stability of the financial system

446 ESMA guidelines on 'Delay in the disclosure of inside information', ESMA 2016/1478 of 20 October 2016. The FCA in DTR 2.5.4[G] (1)(a) and (b) further breaks down para 5(1)(8)(a) of the guidelines that it does not extend to delaying public disclosure of the fact that the issuer in financial difficulty or of its worsening financial conditions, and that delay of disclosure of inside information does not relate to the issuer's position in subsequent negotiations

447 Article 17(4) MAR. Further Article 17(5) MAR provides for the circumstances in which an issuer that is a credit institution or a financial institution in order to preserve the stability of the financial system can delay the public disclosure of inside information, including information which is related to a temporary liquidity problem

An issuer or EAMP can carry out selective disclosure, in which they disclose inside information to certain categories of recipients in addition to those employees of the issuer who require the information to perform their duties.[448]

4.6. Whistleblowing

Whistleblowing is another intelligence mechanism available to the FCA and regulated firms in detecting and preventing financial crimes including insider dealing.[449] The main idea behind whistleblowing is that workers as set out in section 43K of the Employment Rights Act 1996, who become aware of or suspect any misconduct should through appropriate procedures be able to report this potential or actual misbehaviour to the firm in question and/or the FCA.[450] Thus, the FCA must ensure that that whistleblower after having blown the whistle on insider dealing will not suffer negative repercussions as the result of the disclosure.[451] However, the FCA's in implementing the whistleblowing regime runs up against several challenges.[452]

First of all, section 43B and section 348 of the Public Interest Disclosure Act 1998 provide for protected disclosures. The following requirements should be met, that a criminal

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448 DTR 2.5.7[G]. For example, such recipient can be, major shareholder of the issuer, or credit-rating agencies, or the Bank of England

449 J H Wilde, 'The deterrent effect of employee whistleblowing on firms' financial misreporting and tax aggressiveness' (2017) 92 The Accounting Review 247; J Chen, K C Chan and F Zhang, 'Internal control and stock price crash risk evidence from China' (2017) 26 The European Accounting Review 125; FCA, Annual Report and Accounts 2022/23, HC 1578, 25; J Varelius, 'Is whistle-blowing compatible with employee loyalty?' (2009) 85 Journal of Business Ethics 263; J A Batten, I Loncarski and P G Szilagyi, 'Financial market manipulation, whistleblowing, and the common good: evidence from the LIBOR scandal' (2021) 58 Abacus 1

450 SYSC 18.6.1[R] for UK MiFID obligations, and SYSC 18.6.4[R] for market abuse. See also, T Barnett, D S Cochran and G S Taylor, 'The internal disclosure policies of private-sector employers: an initial look at their relationship to employee whistleblowing' (1993) 12 Journal of Business Ethics 127

451 T M Devin and D G Aplin, 'Whistleblower protection - the gap between the law and reality' (1988) 31 Horward Law Review 223; FCA, Annual Report and Accounts 2021/22; FCA, 'The FCA's response to the Parliamentary Commission on Banking Standards, October 2013. The FCA's Senior Management Arrangements, Systems and Controls Sourcebook in Chapter 18 provides for guarantees of whistleblowers, SYSC 18.3.1[R]

452 Ibid

offence has been committed, is being committed or is likely to be committed, and that a person has failed, is failing, or is likely to fail to comply with any legal obligation to which he is subject. Furthermore, section 131A FSMA 2000 on protected disclosures sets out three conditions being relevant to insider dealing according to which the disclosure obligations are not breached. The first condition is that the information or other matter causes the person making the disclosure to know or suspect or gives him reasonable grounds for knowing or suspecting that another person has engaged in market abuse, or that person has engaged in insider dealing or market manipulation. The second condition is that the information or other matter disclosed came to the discloser in course of his trade, profession, business or employment. The final condition is that the disclosure is made to a nominated officer as soon as is practicable after the information or other matter comes to the discloser.

Despite that the existing legislation provides for protected disclosure, the FCA's whistleblowing qualitative assessment survey 2022 revealed the drawbacks in the whistleblowing regime. According to this survey more than half of the respondents were 'extremely or somewhat dissatisfied' with the way the FCA handled their reports.[453] The FCA has acknowledged the identified shortcomings, and announced in May 2023 that it would carry out a number of steps to improve whistleblower confidence.[454] It is important to improve on this aspect because for instance as opposed to the practice in the U.S., where whistleblowers under the Insider Trading and Securities Fraud Enforcement Act of 1988 are allowed to be paid bounties, in the UK the FCA turned down any monetary reward for whistleblowing for this possibility could give whistleblowers a perverse incentive to sidestep internal reporting systems put in place by firms.[455] Having turned away such monetary incentives, the FCA

[453] FCA, Whistleblowing qualitative assessment survey 2022, available at https://www.fca.org.uk/data/whistleblowing-qualitative-assessment-survey-2022#prescribed-person, accessed 13 December 2023

[454] FCA, FCA sets out steps to improve whistleblower confidence, 04 May 2023, available at https://www.fca.org.uk/news/press-releases/fca-sets-out-steps-improve-whistleblower-confidence, accessed 13 December 2023

[455] See for example, HC Select Committee on Trade and Industry, HC 36 1990, and more recent see Note by the FCA and the PRA for the Treasury Select Committee, ‘Financial Incentives for Whistleblowers’, July 2014, available online at https://www.fca.org.uk/publication/financial-incentives-for-whistleblowers.pdf, accessed on 10 October 2022

heavily relies on firms and their procedures for enabling employees to report misconduct and the employees should be confident that the FCA will protect their disclosure(s).

4.7. Market cleanliness statistics

Insider dealing can be detected through a methodology called market cleanliness statistics (hereinafter the MCS).[456] This methodology was introduced in 2006 and it differs to the previously discussed mechanisms as it does not hinge on a report by a third party. The MCS looks at share prices movements in the two days ahead of regulatory announcements and compare them to normal share price movements. Of course, the MCS cannot give a one-hundred-per cent indicator of insider dealing, even when the level of abnormal pre-announcement price movements (hereinafter APPMs) is high, as these scales could be affected, to name a few, by media reports, accurate predictions of financial analysts, or noise as it was discussed in chapter two.[457] Therefore, when computing APPMs there is no expectation that the results will be zero in the absence of any insider trades, but on average ten per cent for the takeovers data set and three per cent for the set of other significant trading announcements made by FTSE 350.[458] Statistically significant results would be those with a movement of five per cent in either direction.[459]

Before the credible deterrence approach was introduced in 2007, the market cleanliness statistics for takeover announcements were close to 30 per cent, and in the first years after the FCA replaced the FSA, there was a palpable fall-off of an average 13.88 per cent across 2014 to 15.1 per cent in 2013.[460] In 2019, the market cleanliness statistics were higher than in the

[456] FSA, Occasional Paper, March 2007, and FSA, Market Watch, April 2008, B. Dubow and N. Monteiro, FSA, measuring market cleanliness, Occasional paper series 23, March 2006

[457] Ibid, FCA, Annual report and accounts 2022/2023, for the year ended 31 March 2023, HC 1578

[458] Ibid

[459] Ibid

[460] FCA, Annual Report 2014/15, 33. Yet again these statistics can be misleading, as such swings might have been due to many other reasons, FCA, OP No 4, 'Why has the FCA's market cleanliness statistic for takeover announcements decreased since 2009', 2014, available at https://www.fca.org.uk/publication/occasional-papers/op-4-market-cleanliness.pdf, accessed 10 October 2020

previous years,[461] at 17.5 per cent.[462] In 2020, due to the pandemic crisis this figure went up to 21.9 per cent.,[463] and in 2022, the statistics came to 24.6 per cent.[464]

In addition to the MCS metric, the FCA deploys two other ratios. Abnormal Trading Value (hereinafter the ATV) encompasses price-sensitive announcements, and captures much more financial products, such as, contracts for difference. An increase prior to the ATV can be indicative of insider dealing.[465] The ATV works in the following way. There are two periods, the benchmark period beginning the 30 days ahead of the announcement ending 10 days before the announcement.[466] In 2018, there were 1070 announcements tested, 68 of which were statistically significant coming to 6.3 per cent.[467] In 2019, the ratio remained the same after more announcement, 1750 were tested, where 112 announcements were statistically significant. [468] In 2022, the ATV was 8.4 per cent.[469]

Another ratio is called Potentially Anomalous Trading (hereinafter the PATR), which examines profitable trading around potentially price-sensitive news announcements (hereinafter PPSNAs) following the announcement.[470] As opposed to the ATV, the PATR is not looking for trading volume fluctuations, or price changes ahead of unexpected price-sensitive

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[461] C Binham, 'Suspect share trades preceded one in 10 UK takeovers last year', FT (London), available at https://www.ft.com/content/493d0626-a242-11e9-a282-2df48f366f7d, accessed 5 March 2021

[462] FCA, Market Cleanliness Statistics, 10 September 2020

[463] L McNulty, 'FCA suspects insider dealing in almost 25% of activity in 2020' (2021) 15 July, Financial News

[464] FCA, Market cleanliness statistics, 2022/23

[465] FCA, Abnormal Trading Volume Ratio, 9 July 2019, available online at https://www.fca.org.uk/data/abnormal-trading-volume-ratio, accessed on 10 October 2020

[466] Speech by M. Steward, Executive Director of Enforcement and Market Oversight at the FCA, 'Market Integrity and Strategic Approach', delivered at the 19th Annual Institute on Securities Regulation in Europe, 6 February 2020

[467] FCA (n 452)

[468] Ibid, these numbers are based on 1,750 announcements 112 out of which observed abnormal increases

[469] Ibid

[470] FCA, Potentially Anomalous Trading Ratio, 10 September 2020, available online at https://www.fca.org.uk/data/market-cleanliness-statistics/potentially-anomalous-trading-ratio, accessed on 10 October 2020. This new ration captures CFDs and spread bets that are traded on OTCs this give the FCA a wider pool of data to analyse

announcements. Instead it focuses on the underlying trading behaviour around the PPSNAs and whether the behaviour can be deemed anomalous.[471] In other words, within the observation period, the FCA identifies those accounts exhibiting anomalous behavioural patterns when compared to their historical trading behaviour.[472] In 2019, 99.2 per cent of trading activity did not occur during a sensitive period (i.e. preceding a PPSNA, where the price of the relevant security moved significantly). For this remainder of 0.8 per cent, the PATR shows that only 6.7 per cent of that trading was considered potentially anomalous, a tiny percentage compared to the overall trading volumes.[473] In 2021, the PATR was 6.1 per cent, and in 2022 it was 4.7 per cent. The statistics for 2022 show that 99.5 per cent of trading activity did not occur during a sensitive time period, for the 0.5 per cent of trading activity only 4.7 per cent was considered potentially anomalous.[474]

4.8. Enforcement of insider dealing

The FCA is expected to exercise its powers in a transparent, proportionate and responsive manner and act consistently with its publicly stated polices.[475] The legal powers in Table 3 below were identified through exploring the relevant legislation.

Table 3. The powers of the FCA

Article/Act	**Description**
Section 97 FSMA 2000	Appointment by the FCA of persons to carry out investigations

[471] Ibid

[472] Ibid. Anomalous behaviour usually has the following features, (i) the participant does not typically trade in the instrument (e.g., detected through a Benchmark Period), (ii) he trades more in the direction of the announcement, and (iii) he makes a profit (<£5,000 for an individual, and <£50,000 for a legal entity)

[473] Ibid

[474] FCA (n 456)

[475] Enforcement Guide 2.1.2

Section 56 FSMA 2000	Prohibition orders
Section 122A FSMA 2000	Power to require any information from issuers, i.e., PDMRs and associated persons
Section 122B FSMA 2000	General powers to require information, and specified information
Section 122C FSMA 2000	Power to require information and production of documents. If a person fails to comply with the FCA's requests, they can be found guilty of court contempt under section 122F(2) FSMA 2000
Section 122D FSMA 2000	Entry of premises under warrant
Section 56, 123A and 123B FSMA 2000	Administrative and disciplinary sanctions, such as, prohibiting individuals from dealing, suspending permission to carry on regulated activities, a temporary prohibition on an individual holding an office or position involving responsibilities for taking decisions about the management of an investment firm, and/or an individual acquiring or disposing of financial instruments irrespective of whether on her own account or the account of a third part directly or indirectly
Section 123 FSMA 2000	Power to impose penalties or issue censure The FCA can impose a penalty of such amount as it considers appropriate on the person
Section 131E FSMA 2000	Power to require information (in relation to short-selling)
Section 131G FSMA 2000	Power to impose penalty or issue censure (in relation to short-selling)
Section 63 FSMA 2000	Withdrawal of approval
Part XI Information Gathering and Investigations FSMA 2000	Powers to gather information Appointment of investigators Assistance to overseas regulators Conduct of investigations
Part XIV Disciplinary measures	The following disciplinary measures are available, public censure in section 205, financial penalties in section 206 and section 206A sets out suspending permission to carry on regulated activities etc.

Section 284 FSMA 2000	Power to investigate, the affairs of, or of the manager or trustee of, any authorised unit trust scheme
Section 402 FSMA 2000	Power of the FCA to institute proceedings for certain other offences, where (1)(a) Part V of the CJA 1993 (insider dealing)
Part 18A FSMA 2000	Suspension and removal of financial instruments from trading
Part XXV FSMA 2000	Injunctions and Restitution
Part 2 SOCA (Serious Organised Crime and Police Act 2005)	Investigations, prosecutions, proceedings and proceeds of crime Chapter 2 Offenders assisting investigations and prosecutions
Article 23 UK MAR	Powers of competent authorities
Enforcement Guide 4.7	Use of statutory powers to require the production of documents, the provision of information or the answering of questions
Enforcement Guide 4.11	Approach to interviews and interview procedures
Enforcement Guide 4.12	Search and seizure powers
Schedule 5 to the Consumers Right Act 2015	Investigatory powers etc.
Part II of the Regulation of Investigatory Powers Act 2000 (RIPA 2000)	Surveillance and covert human intelligence sources
The Company Directors Disqualification Act 1986	Powers to disqualify directors of companies

This thesis will not go into detail about these powers independently but will touch upon some of them contextually.

4.8.1. The investigation process

Once insider dealing has been detected, the FCA decides whether to commence an investigation into the matter.[476] An investigation is carried out by an appointed investigator(s) in accordance with sections 167[477] and 168 FSMA 2000.[478] The scope of their enquiry is typically concerning the nature, conduct and/or state of the business of an authorised person or its representative.[479] Skilled persons can be hired by a firm or the FCA further to sections 166 and 166A FSMA 2000 to produce a report on particular aspects of the subjects of the investigation activities.[480]

Normally, at the moment of detection and preliminary investigation there is no observable difference between the criminal and civil regimes as either can be enforced by the FCA. Only after the preliminary investigation and based on section 12.3.2. of the Enforcement Guide (hereinafter the EG) listing a non-exhaustive list of factors pointing to the necessity for opting for the criminal regime, FCA staff decides which regime is to be enforced.[481] To initiate a criminal prosecution, the FCA must act in conformity with the evidential threshold of the Crown Prosecution Service Code.[482] In view of the risk-based approach and limited resources,

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[476] REC 4.2F, Part XI FSMA 2000. An investigation is carried out by an appointed investigator(s) in accordance with sections 167 and 168 FSMA.

[477] The difference between section 167 FSMA 2000 and section 168 FSMA 2000 in that the latter refers to general investigations, such as the nature, conduct or state of the business, the ownership or control of a RIE and so on, whereas the former is for particular cases, in which the FCA believes an offence(s) has been committed. The powers of such investigators are set out in sections 171, 172 and 173 FSMA 2000. In addition, the FCA can appoint additional investigators EG 4.4.1

[478] Section 168 FSMA 2000 sets out the procedure for appointing persons to carry out investigations in particular cases, where paragraph (2)(d) refers to insider dealing and market manipulation

[479] Section 167 FSMA, and sections 171 and 172 FSMA 2000 lay out the powers of such appointed investigators

[480] Normally this power is exercised when the FCA needs some further analysis. Such a skilled person can be appointed either by recommendation of a regulated firm, if approved, or by the FCA itself. For further information in relation to skilled persons

[481] FCA, 'Issuing statutory notices - a new approach to decision makers' PS21/16, November 2021, DEPP 4 on Decisions by senior staff committee

[482] 4.6 the Code for Crown Prosecutors

the FCA should be relatively certain that it is in possession of adequate evidence to carry the case through.[483] For example, recall from the earlier discussion suspicious transactions and orders reports (STORs), where the FCA receives a relatively large amount of STORs, but not every STOR will be investigated, but only those instances will further be looked into having the highest likelihood of successful prosecution. As a result, some offenders will therefore get away with impunity either due to being overlooked or the FCA being unable to prove insider dealing. For the FCA in this process the most important element is not what the FCA thinks happened, but what the FCA can prove.[484] Therefore, the purpose of this investigation is to ascertain what has happened and then decide whether or not to commence formal enforcement action.[485]

4.9. The problematic notion of inside information: a quantification issue

This section will aim to answer question (e), that is, whether the law on insider dealing hinders the effectiveness of insider dealing regulations. Centering on the problem with identification of inside information, a quantification issue will be unpicked and developed by reason of which this thesis will argue that irrespective of the regime the FCA cannot and hence should not be certain as to the correctness of quantified illegal gains from insider dealing for the purposes of a financial penalty imposition.[486] In chapter six this discussion will be expanded on but only in relation to the civil regime.

A quantification issue has been acknowledged in the the FSA Consultation Paper 09/19, where it was stressed that it would be difficult to identify the financial benefit for the purposes of disgorgement. In the Economics for Effective Regulation paper, it is recognised that the

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[483] HMT, Review of enforcement decision-making at the financial services regulators: final report, December 2014, para 2.3, 2.8

[484] Ibid

[485] J Symington, Our investigations – the evolving approach', Director of Investigations at the FCA, Speech at the Legal Week Banking Litigation and Regulation Forum, 15 June 2017

[486] This problem of quantification was raised by Manne (n 30)

quantification of the harm to the market is challenging.[487] Having this quantification issue understood is essential inasmuch as given a relatively high certainty of detection,[488] but with a relatively low certainty of punishment, the quantification issue can impact the severity criterion especially in the civil regime as it will be elaborated on later in the thesis.

The quantification issue will be looked at through the following arguments,

* inside information is difficult to identify by persons creating, co-creating or in possession of inside information for the purposes of public disclosure of inside information,[489]

* insider dealing can be as illegal as legal owing to various exemptions and defences under both the regimes,

* an insider's knowledge of the fact that they deal in inside information for criminal cases.

On the strength of these arguments it will be contended that the FCA cannot accurately, at least not constantly, quantify the exact amount of illegal gains since neither firms nor the FCA know for certain how much inside information is out there being improperly disclosed, leaked, dealt in and/or created. As it was pointed out in the Conclusion to chapter two based on the social-welfare argument it is problematic bordering on being not feasible to gauge gains and losses when informed traders benefit from the majority's losses, and their estimation of the obtained benefits leading to the quantification issue. In fact, the nature of insider dealing law resembles a spaghetti of exemptions in about as many restrictions which further complicate the quantification issue because it is barely possible to separate legal insider dealing from illegal insider dealing in the myriads of transactions.

4.9.1. The definition of inside information

[487] Z Iscenko, P Andrews, K Dambe, and P Edmonds, 'Economics for effective regulation', (2016) FCA Occasional Paper 13

[488] Mark Steward, former director of enforcement and market oversight at the FCA pointed out after completing operation Tabernula in which a number of high profile insiders were sentenced to prison terms

[489] FCA, Best practice note- identifying, controlling and disclosing inside information, Last updated 9 January 2023,https://www.fca.org.uk/markets/best-practice-note-identifying-controlling-and-disclosing-inside-information, accessed 10 September 2023

Before delving into expounding the arguments underpinning the quantification issue, it is necessary to enter several notes. First, there is a little difference between the criminal and civil elements of insider dealing offences.[490] Second, the elements of inside information under article 7 UK MAR are rather similar to that of section 56 CJA 1993.[491] Information to be regarded as being inside must meet the following criteria under article 7 UK MAR:

* inside information is of a precise nature. Under section 56(1)(b) CJA 1993, inside information may be either precise or specific. For instance, specific information is knowing when a bid is going to be placed, and precise is, the price at which this bid is going to made,[492]

* inside information is not yet public,

* inside information relates directly or indirectly to one or more issuers or to one or more financial instruments[493] on a regulated market,[494]

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[490] Articles 8, 10 and 14 UK MAR and section 52 CJA 1993 set out three offences of insider dealing, namely, (1) dealing in price-sensitive inside information as an insider on a regulated market or through a professional intermediary, or himself as a professional intermediary, (2) encouraging a third person(s) to deal in price-sensitive inside information in relation to particular financial instruments and (3) unlawful disclosure of inside information, or tipping, otherwise than in the proper performance of the functions of his employment, office or profession. There are the following differences between the regimes: the criminal regime covers only individuals, whereas the civil regime's coverage embraces both individuals and legal persons; under the criminal regime an individual can face up to 10 years imprisonment, an unlimited fine and an administrative sanction, whereas under the civil regime a legal person or an individual can be financial penalised by an unlimited fine or be publicly censured with an administrative sanction; for the purposes of article 8(4) UK MAR, the person concerned does not need to know that the information concerned is inside information, MAR 1.2.9[G], whereas under section 57 CJA 1993, the insider concerned should know that it is inside information

[491] The difference is that under section 56 CJA 1993 inside information can be either specific or precise, whereas under the civil regime it should only be precise

[492] HC Standing Committee B, Fifth Sitting, Thursday, 10 June 1983, col. 174

[493] Both the regimes cover the same types of financial instruments. See, Recital 8 and article 3(2)(a) and (b) UK MAR set out that any financial instrument being traded, admitted to trading or for which a request for admission to trading has been or not been made falls within the scope of Regulation. Schedule 2 to the CJA 1993 embraces similar financial instruments

[494] In the civil case of *Phillipe Jabre and FSA* (Financial Services and Markets Tribunal) FIN 2006/0006 of 10 July 2006, the insider appealed the decision of the FSA on the grounds that he did not deal in securities on a UK market. The accused was sounded out about a Japanese bank (the bank's shares were quoted on the London Stock Exchange SEAQ international trading system) and warned not to make any subsequent trades on the basis of this

* inside information if it were made public, would be likely to have a significant effect on the prices of those financial instruments or related derivatives. According to DTR 2.2.4[G](2), there is no benchmark for calculating a significant effect on the price of financial instruments, but as it was suggested in the case of *Hannam*, a 1p increase in a share worth 10p may be trivial, but in a share worth 2p it is significant.[495]

4.9.2. The difficulties identifying inside information

This discussion will relate to two categories of challenges. The first category are the challenges associated with the identification of inside information for the purposes of detecting, preventing and reporting suspicious transactions and orders to the FCA by financial services firms. The second category are the challenges associated with identifying inside information by firms generating, co-generating or possessing inside information for the purposes of public disclosure of inside information under Article 17 UK MAR or section 58 CJA 1993.

Financial services firms, such as, brokerage firms, investment firms and the like, must comply with Principle 3, namely, '[a] firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems'.[496] In 2022, the FCA imposed a financial penalty in the amount of £4,775,200 on BGC Brokers LP, GFI Securities Limited and GFI Broker Limited for failing to operate in accordance with Principle 3.[497] The reason for such a hefty penalty was that these firms' systems for monitoring insider dealing did not cover multifarious financial instruments ranging from equity derivatives to

information. In defiance of this warning he had conducted a number of short sales through the Tokyo market. The Tribunal ruled that it does not matter where the abusive behaviour has taken place, as long as it relates to a UK market, paragraph 28. For the reason that then anyone who received inside information in relation to a FTSE 100 company could trade outside the UK. As regards the criminal regime, see section 62 CJA 1993 and owing to HM Treasury the Insider Dealing (Securities and Regulated Markets) Order 2023, section 62(1)(b) of the CJA 1993 now includes UK, EU, or Gibraltar regulated markets, multilateral trading facilities, and organised trading facilities. Likewise, any market established under the rules of NASDAQ, SIX Swiss Exchange or NYSE

[495] *FSA v Hannam* [2014] UKUT 0233 (TC) Appeal FS/2012/0013, para 120

[496] PRIN 2.1.1[R]

[497] FCA, Final Notice to BGC Brokers LP 454814, GFI Securities Limited 184801 and GFI Brokers Limited 184786 of 7 December 2022

commodities.[498] As a result, no suspicious transaction and orders report (STOR(s)) was passed on to the FCA.[499] In another, but similar case in 2018, the FCA financially sanctioned Interactive Brokers (UK) Limited in the amount of £1,049,412 for disregarding Principle 3 between 6 February 2014 and 28 February 2015. As a result, no STOR was submitted to the FCA within this timeframe.[500] There was another case against W H Ireland, a financial services firm, which was fined £1,200,000 also for breaching Principle 3 during a period between 1 January and 19 June 2013.[501] As a consequence, these firms, not to mention the FCA, could not possibly know how much inside information was illegally utilised during those periods of non-compliance.

Pertaining to the challenges associated with identifying inside information by firms generating, co-generating or possessing inside information for the purposes of public disclosure of inside information under Article 17 UK MAR or section 58 CJA 1993, a case against Tejoori Limited (hereinafter Tejoori) will be worth looking at. Tejoori, a close-ended company was penalised £70,000 by the FCA for failing to disclose inside information to the public when it should have been disclosed.[502] In early 2016, Tejoori owned shares in BEKON Holding AG, a German renewable energy firm which was being taken over by Eggersmann Gruppe GmbH & Co. Kg. The shareholders' agreement contained a drag-along provision according to which Tejoori would have to sell its shares to Eggersmann without initial consideration with the possibility of receiving deferred consideration which was much less than Tejoori's valuation of its investment.[503] Shortly after Tejoori's shares were transferred to Eggersmann, both BEKON and Eggersmann made announcements but did not indicate Tejoori in them. In about a fortnight of the date of drag-along notice, Tejoori's share price was rising throughout two days closing 21 per cent and 14 per cent up respectively. This increase was due to the bulletin board speculating over the potential amount of consideration received by Tejoori, which they mistakenly believed was positive. Tejoori was contacted by its nominated adviser to enquire

[498] Ibid, paragraph 2.7(c)

[499] Ibid, paragraph 2.13

[500] FCA, Final Notice to Interactive Brokers (UK) Limited 208159 of 25 January 2018, paragraphs 2.2. and 2.9

[501] FCA, Final Notice to W H Ireland Limited 140773 of 22 February 2016, paragraph 2.3

[502] FCA, Final notice to Tejoori Limited, 13 December 2017, paragraph 2.2

[503] Ibid, paragraphs 2.3, 2.4. and 2.5

about the nature of price rise to which Tejoori responded that they did not possess inside information nor that they sold their shares to Eggersmann. Tejoori's legal adviser corrected this information after which a public announcement was made that Tejoori sold its shares in BEKON without initial consideration. Tejoori's share price closed 13 per cent down on that day.[504]

The FCA in its Final Notice to the firm in paragraph 5.14 indicates that,

> 'The Board mistakenly believed that Tejoori's shares in BEKON would not be transferred to Eggersmann until the deferred consideration was received, at which point the actual value of the shares would be known. As a result, the Board mistakenly believed that the value of Tejoori's investment in BEKON would not change by entering into the SPA [*Author Note: Sale and Purchase Agreement*] with Eggersmann and it did not understand, until 23 August 2016, that Tejoori's shares in BEKON had been transferred to Eggersmann on 10 August 2016.'

For the purposes of this discussion it is irrelevant whether Tejoori was genuinely not aware of being in possession of inside information or not, but what matters is the very possibility of raising this question. In other words, there is a probability that a firm is unable to discern the presence of inside information to be disclosed to the public, which means that if firms generating, co-generating or in possession of inside information can misidentify inside information then inside information can be unintentionally misused. Tightening disclosure requirements can stifle innovation as firms will be wary of contravening the law by not being prompt in disclosing or misidentifying inside information[505] or bringing about processes in financial markets which will be as complex as not transparent.[506] Equally as undesirable as

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504 Ibid, paragraph 2.10

505 J Payne, 'Disclosure of inside information' (2019) University of Oxford and ECGI Law Working Paper N422; see also S A Lumpkin, 'Regulatory issues related to financial innovation' (2009) 2009/2 OECD Journal Financial Markets Trends 1; D Awrey, 'Regulating financial innovation: a more principles-based proposal?' (2011) 5 Brooklyn Journal of Corporate, Financial & Commercial Law 273; S A Lumpkin, 'Regulatory issues related to financial innovation', (2009) OECD Journal Financial Market Trends

506 D Katz, 'Dodd-Frank Mortgage Rules Unleash Predatory Regulators', (2013) The Heritage Foundation, No 2866; and The Bank of England, 'Instruments of macroprudential policy' (2011) Discussion Paper. Financial innovations are also devised in response to regulatory constraints see for example M Ben-Horim and W L Silber, 'Financial innovation, A linear programming approach', (1977) 1 Journal of Banking and Finance 277, and W L Silber, 'The process of financial innovation', (1983) 73 The American Economic Review 89

over-straining is over-lessening regulations so there should be reasonably proportionate requirements imposed on legal firms.[507]

The first and second categories of challenges therefore pose significant concerns for both the firms and the FCA not only in the reasons discussed above, but also due to various exemptions and defences to insider dealing and legitimate practices and so on turning insider dealing into a legal occupation in which both the firms and the FCA can muddle up legal with illegal insider dealing.

4.9.3. Legal versus illegal insider dealing

Insider dealing can be as illegal as legal owing to various exemptions and defences under both the regimes. In this sub-section we will discuss the following exemptions, (i) market soundings under article 11 UK MAR and (ii) other available exemptions and defences to insider dealing.

The issue with market soundings

A market sounding comprises the communication of inside information, prior to the announcement of a transaction to gauge the interest of potential investors in a possible transaction and the conditions relating to it to one or more potential investors.[508] Market soundings normally occur in secondary offerings, accelerated bookbuilding when the offeror is a shareholder or a company.[509] In essence, a market sounding is a lawful disclosure of inside information against section 52(2)(b) CJA 1993 and article 10 UK MAR prohibiting unlawful

[507] According to Principle 3 of good regulation, the FCA must ensure that any burden or restriction that they impose on a person, firm or activity is proportionate to the benefits they expect as a result. To judge this, they take into account the costs to firms and consumers

[508] Commission Delegated Regulation (EU) 2016/960 of 17 May 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings, as amended by FCA 2019/45

[509] S Lombardo and F M Mucciarelli, 'Market soundings: the interaction between securities regulation and company law in the United Kingdom and Italy' (2019) 3 European Company and Financial Law Review 310

disclosure of inside information, otherwise than in the proper performance of the functions of employment.[510]

In order to carry out a market sounding, a disclosing market participant (hereinafter the DMP) shall satisfy a number of requirements, such as, (i) identify any inside information, (ii) maintain and update a written record of disclosed information, (iii) obtain the consent of the market sounding recipient (hereinafter the MSR), (iv) inform the MSR that they are prohibited from using that information, (v) keep the information confidential, (vi) when the disclosed information ceases to be inside information the disclosing party shall inform the recipient. But the recipient also shall assess for itself whether it is in possession of inside information, or when it ceases to be inside information.[511]

There is no obligation on the MSR to report any improper disclosure of inside information.[512] The risk of improper disclosure or leak of inside information increases when there is more than one MSR on account of inside information passing numerous hands. If the DMP has not kept the log of the MSRs, it will be very onerous to hunt down the insiders. Another problem with article 11(7) UK MAR obliging the MSR to carry out its own assessment on whether the received inside information, or any other related information, is inside information. This is problematic because for example, the MSR receives different chunks of information from several sources where with adding the DMP's information, which may have been non-inside information, if put together will amount to inside information.[513] In this scenario, the MSR should not disclose it to the DMP, but if the DMP relays in its opinion non-inside information and the MSR believes this communicated information to be inside, this discrepancy of opinion should be conveyed to the DMP.[514]

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[510] MAR 1.4.3[G], and MAR 1.4.4A[G](1)

[511] FCA, Market Watch 63, May 2020; ESMA, Final Report, Guidelines on MAR – market soundings and delay of disclosure of inside information, ESMA 2016/1130 13 July 2016, para 16. If the MSR agrees it must be warned by the DMP that this information is prohibited from using and keep it confidential, Article 11 UK MAR

[512] Ibid, para 29

[513] Ibid, para 20

[514] Ibid, para 24. And the opposite is true as well, i.e. when the DMP informs the MSR that the disclosed information is inside information, but the MSR after its own assessment believes it is not inside information, para 25

The issue with other forms of exemptions and defences

UK MAR and the CJA 1993 provide for a number of exemptions from insider dealing such as, buy-back and price stabilisation programmes,[515] exemptions for monetary and public debt management activities and climate policy activities,[516] other legitimate behaviour under article 9 of UK MAR and statutory defences as set out in section 53 CJA 1993[517] and special defences under Schedule 1 to the CJA 1993. The thesis will not uncover all of such exemptions for it falls outside the scope of the research and the word count limitations, instead it will highlight the very fact that there are exemptions on the one hand and illegal insider dealing on the hand. This reality gives rise to two questions. First, in terms of potential losses suffered by uninformed investors, does it really matter whether they incur losses as a result of legal or illegal insider dealing? The determination of legal and illegal insider dealing in this connection is premised on the wording of the law, so that under certain circumstances and for some efficiency considerations insider dealing is justified. Alternatively, there cannot be insider dealing if an alleged insider dealing can raise a statutory defence under the CJA 1993 or show that they acted legitimately as set out in UK MAR. Here it is still the law which delineates the boundaries of legal and illegal insider dealing, but economic efficiency considerations are irrelevant for these cases. Should a loss incurred by the uninformed investors be contingent on the wording of the law? Consequently, insider dealing can be legal for economic efficiency purposes or when the prosecutor cannot prove the elements of insider dealing.

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[515] Article 5 UK MAR and Schedule 1 to the CJA 1993. Price stabilisation permits a manager of an issuer of securities, e.g. to purchase shares in order to stabilise/maintain the market price of those securities. Buy-back programme is when a company repurchases its own outstanding shares with a view to paring down the number of their shares on the market. Commission Delegated Regulation (EU) 2016/1052 of 8 March 2016. In addition to the list of bodies under article 5 UK MAR, there is a list of third countries public bodies and central banks which are exempted under Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014

[516] Article 6 UK MAR

[517] Which are (i) an individual will not be guilty if he 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, (ii) an individual at that time 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, and (iii) or that he would have done what he did even if he had not had the information. There are also defences in relation to the unlawful disclosure and encouragement insider dealing offences under the same section of the CJA 1993

The thesis finds these two questions captivating not only because of the complexities of insider dealing, but mainly because they lead to a third question, can the FCA at the initial stages of observing suspiciously abnormal price movements patterns, receiving intelligence and so on, tell the difference between legal and illegal insider dealing? It is not entirely clear whether a person who was entitled to deal in inside information, where as a result of such trades they somehow legally generate some profit, but then if that person improperly discloses that inside information to a third party, or carries on dealing in price-sensitive information far beyond the permitted period, will those legal profits be retained notwithstanding that they violated the terms and conditions of lawful dealing? Will the FCA be able to separate out the profits and if necessarily trace them back to the original dealings and will the third party be liable for any dealings they executed on the basis of that improperly disclosed inside information. There are more questions to answers indicating that the quantification issue is a persistent and ineradicable challenge emerging from these overarching problems with the nature of insider dealing.

4.9.4. Knowledge of an insider

According to section 57 CJA 1993, an insider is an individual who has information if and only if, it is, and he knows that it is, inside information, and he has it, and knows that he has it, from an inside source.[518] For the purposes of UK MAR this element is not consequential.[519]

The problem with this element can be observed in section 57(2)(b) CJA 1993 creating tippee liability. Tippee liability arises when an individual garners inside information either directly or indirectly from an individual falling within section 57(2)(i) and (ii) CJA 1993. A tippee can be a person within earshot of a conversation between two managers kicking around some inside information, or within eyeshot of some graphical representation of information on a computer screen and so on. Here, the person does not know the original source of such information, but he knows that it is inside information. The prosecution does not have to prove

[518] Gleans inside information through being a director, employee or shareholder of an issuer of securities, or having access to the information by virtues of employment, office or profession, or through professional intermediaries as set out in section 59 CJA 1993

[519] MAR 1.2.9[G]

that he was casting about for this information when he obtained it, or that the original source of that information had been unlawfully disclosed.[520]

It is a challenge for the FCA to prosecute someone for tipping-off. As an illustration, there was a case of a former investment banker called Amman. In late 2008 and 2009, while working on a merger and acquisition deal for Canon Inc., he became privy to inside information.[521] Amman was falling on hard times and talked his two girlfriends, who did not know about each other's existence, into investing their savings into the target's company shares. One of his girlfriends, Weckwerth on the basis of his encouragement invested £808,000. The other girlfriend sank all the money she had into buying the shares, to which Judge Leonard QC points out, '…to further a loving relationship she scrapped together every penny…amassing £39,000…'..[522] The jury acquitted the two girlfriends, and the court permitted them to keep their profits, as it was proven that they had no idea as to the underlying nature of the dealings. Therefore, tippee liability could not be used. In contrast, Amman was imprisoned for two years and eight months.

This case is interesting because it demonstrates the two to an extent contradicting dimensions of insider dealing. Legally speaking, both girlfriends were allowed to keep the profits, in spite of the fact that, financially speaking, this £847,000 is someone's losses going against the social welfare argument as discussed in chapter two. The thesis will not go into detail on as to why the law was written in this way, but rather underscores this challenge to proving the insiders' state of knowledge at the moment of dealing in inside information.

[520] MAR 1.3 provides a few insider dealing examples. See K Coles, 'The dilemma of the remote tippee', (2023) 41 Gonzaga Law Review 181

[521] J Croft, 'Cheating banker jailed for insider trading', 13 December 2012, Financial Times, available at https://www.ft.com/content/d12e2284-450d-11e2-838f-00144feabdc0, accessed 21 February 2021

[522] *R v Amman, Weckwerth and Mang*, (Southwark Crown Court, 24 May 2012). See also A. Martin, 'Investment banker jailed for helping his two lovers make more than £1.5 million by leaking confidential inside information', (2012) The Daily Mail 13 December 2012, available at https://www.dailymail.co.uk/news/article-2247477/Investment-banker-Thomas-Ammann-jailed-helping-lovers-make-1-5m-leaking-inside-information.html, accessed 16 August 2023

4.9.5. Summary of the arguments

The thrust of these three arguments, or challenges is to highlight the difficulties identifying inside information. Such difficulties beset not only the regulated persons, but also impairs the ability of the FCA to detect, prove and hence quantify potential or actual deleterious impact of insider dealing on the markets. Therefore, any quantification of illegal gains for the purposes of a penalty imposition should be deemed to be approximate, despite that, of course there can be correctly quantified illegal gains.

Lack of knowing precisely how much inside information is out there being dealt in, disclosed or created brings about the issue with quantifying illegal gains. Just to illustrate this point again, consider a case of high-frequency trading (HFT), where trades can be executed milliseconds after the disclosure of inside information. Insiders by reasons of pre-set HFT algorithms can generate profits before the prices of financial instruments absorb this new information. The insider can thus legally go about dealing in the now public information without waiting for this information to be reflected in the prices.[523] This example involves a sophisticated insider, but even in situations with say amateur insiders, the FCA will still have to show the casual link between all of the inside information components.

In chapter six, it will be shown that the enforced civil cases in the UK have been predominantly against first-time offenders, i.e., who had not been subject to any criminal, civil, disciplinary or administrative sanction, and one-off events, that is, in relation to a single piece of inside information. However, in view of the quantification issue a financial penalty can be lower than the quantified amount of illegal gains. By extension, it is possible that a first-time offender is in fact a habitual offender and a one-off event in fact was repeated. The duration and frequency of insider dealing are contingent upon a finite amount of time within which a piece of inside information has value, wherein an individual possessing it can earn abnormal profits until this value fades away soon after it was disclosed to the public. But, if the same insider possessed several distinct pieces of inside information then the duration and/or

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[523] Under recital 25 of UK MAR, orders placed before a person possesses inside information are not insider dealing. So, the prosecution must prove that the insider was in possession of inside information at the moment of placing orders; see also A Alcock, 'Inside Information', in ed. B Rider and M Ashe, *The Fiduciary, the Insider and the Conflict*, (Brehon Sweet & Maxwell, 1995), 87

frequency parameters become continuous in the sense that they are splitting off from the (one-off) insider dealing against which a financial penalty is imposed.

Tippee liability arises only when a person knows that they were in possession of inside information at the moment of committing insider dealing. If that person can prove, for whatever reason that they were not aware of this fact, there will be no offence of insider dealing. In the case of *Amman*, as discussed in the previous section, his girlfriends were allowed to keep the profits, because they had not been aware of the fact that they were dealing in inside information, but one might ask a question on behalf of uninformed investors, should it matter that his girlfriends did not know about this fact? Should this single knowledge factor define the effective allocation of resources? Should not this allocation be based solely on the expectations of outcomes to social welfare? This thesis will not aim to answer these questions, and perhaps these questions are unanswerable, but it is interesting to observe this matrix of intertwined law and economics questioning the social-welfare argument discussed in chapter two.

Several pieces of inside information may be not price sensitive, but if adding another piece of inside information the whole batch can become price sensitive. This condition undoubtedly complicates detecting, proving and quantifying irrespective of whether the insider in question intentionally or accidentally violated the law. Fundamentally speaking, why does the law decide when insider dealing is illegal, and when it is legal as under articles 5, 6, 9 and 11 UK MAR, or the statutory defences under section 53 and Schedule 2 to the CJA 1993? For certain economic purposes these exemptions are necessary, but for the purposes of enforcing insider dealing regulations, they make the FCA encounter these quantification challenges.

4.10. The civil regime's penalty-setting framework

This Section will attempt to answer question (f). The discussion will therefore be shifting towards the civil regime's penalty-setting framework, where the basic structure will be defined, and challenges outlined.

The FCA's Decision Procedure and Penalties Manual (hereinafter DEPP) was introduced by the FSA in 2010 to amongst other things create a more transparent and consistent regulatory structure.[524] According to DEPP 6.1.1[G], the purpose of the Manual is to outline the procedure for, amongst other things, the imposition and computation of administrative and civil penalties against insider dealing.[525] The civil penalty-setting regime is based on the following three principles, (1) disgorgement, (2) discipline, and (3) deterrence.[526] The first principle means that, a firm or an individual should not benefit from any breach. The second principles means that a firm or individual should be penalised for wrongdoing, and the third principle means that, any penalty imposed should deter the firm or individual who committed the breach, and others, from committing further or similar breaches.[527]

In accordance with DEPP 6.5.3[G], the total amount payable by a person subject to enforcement action may be made up of two elements, (i) disgorgement of the benefit received as a result of the breach, and (ii) a financial penalty reflecting the seriousness of the breach. These two elements are incorporated in a five-step framework to be discussed below. It should also be noted that, the FCA may instead of a financial penalty impose a public censure on an individual under DEPP 6.4., but since insider dealing cases normally call for a more severe penalty,[528] and there have been only two cases of public censures, see Appendix B, public censures will not be discussed.

The procedure for imposing a civil sanction begins with a warning notice as set out in section 387 FSMA 2000, followed by a decision notice, in which the FCA proposes action to be taken against the person concerned as set out in section 388 FSMA 2000. If this person disagrees with the findings, this person can make a referral to the Upper Tribunal Chancery & Tax Chamber[529] to challenge such a decision with a further possibility to appeal to the Court of Appeal of England and Wales.[530] If he decides not to refer the matter to the Upper Tribunal, the FCA issues a Final Notice as set out in section 390 FSMA 2000.

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[524] FSA, Policy Statement, 'Enforcement financial penalties Feedback on CP10/19', 10 March 2010, para 2.4.

[525] In particular under DEPP 6.5C

[526] DEPP 6.5.2[G]

[527] Ibid

[528] DEPP 6.4.2[G]

[529] The Tribunals, Courts and Enforcement Act 2007 established the Upper Tribunal. See The Tribunal Procedure (Upper Tribunal) Rules 2008, Explanatory Note

[530] Section 63B FSMA 2000

4.10.1. Step 1 - Disgorgement

DEPP 6.5C.1[G] defines Step 1 as follows, '[t]he FCA will seek to deprive an individual of the financial benefit derived as a direct result of the market abuse, which may include the profit made or loss avoided, where it is practicable to quantify this. The FCA will ordinarily also charge interest on the benefit'. For example, at the time of him committing insider dealing, Malins was a co-founder and the only executive director of Cambrian Mining plc, a company traded on AIM in the relevant period.[531] He had come into possession of inside information on which he purchased and then disposed a total number of 70,000 ordinary shares in this company making a profit of £6,400. The total penalty imposed upon him by the FSA was £25,000, but the net penalty was £18,600 after taking away his benefits of £6,400. Therefore, disgorgement of £6,400 is included in the final penalty.

Disgorgement as a penalty element will be thoroughly examined and evaluated in chapter six, here it is necessary to put forward the following arguments given the quantification issue. Disgorgement is not an indispensable component of a financial penalty. Implying that if the FCA is unable to quantify the amount of illegal benefits from insider dealing there will be no disgorgement imposed on an insider. Disgorgement is active if and only if it has been quantified by the FCA. In the absence of disgorgement, the FCA will only impose a financial penalty reflecting the seriousness (hereinafter PRSID) of insider dealing of Step 2 given the adjustments applied at the other Steps, unless a public censure is issued as set out in DEPP 6.4. When a figure for the purposes of disgorgement is quantified it affects the PRSID through DEPP 6.5C.2[G](11)(a), that is, '[t]he level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the market abuse, either directly or indirectly'. It is in bold because from now on this thesis will regularly refer back to this factor. If it is the case, then bearing in mind that the disgorgement's figure is identical to that of the impact factor's figure, the financial penalty that is made up of these two penalty components, i.e., disgorgement and a PRSID, can be bring about under-deterrence because a sanction is disproportionately small to the illegal gains, and even the quantified illegal gains.[532] Even if a disgorgement figure has been determined, there is still a possibility of erring as the insider may not have closed his

[531] FSA, Final Notice to Jonathan Malins, 20 December 2005

[532] IOSCO (n 3), paragraph 86

position after the disclosure of that inside information,[533] or that the insider had tipped a third party off that there would a profitable opportunity in relation to the financial instrument in question. Therefore, it is essential that the FCA ensures a financial penalty to be greater than the quantified illegal gains as this information is disseminated to would-be offenders.

It should be clear that this impact factor affects the magnitude of a PRSID, and this impact factor's figure mirrors the figure quantified for the purposes of disgorgement creating quite a convoluted interrelationship between the elements. Essentially, it implies that when disgorgement has been quantified, it indirectly has a bearing on a PRSID through the impact factor, because the disgorgement and the impact factor represent the same figure. Although, disgorgement is a penalty under DEPP, in practice the FCA can replace disgorgement with restitution in cases where the victims of insider dealing can show the casual link between them and insider dealing.

4.10.2. Step 2 - Seriousness of insider dealing

The financial penalty reflecting the seriousness of insider dealing (PRSID), is determined by considering various factors under DEPP 6.5C.2[G]. It should be noted that, although the civil regime is being discussed, the factors indicating the potential enforcement of the criminal regime as set out in the FCA's Enforcement Guide (EG) will also be referred to. First, this Section will cover how a PRSID is calculated in market abuse cases against individuals. Second, this Section will touch upon the factors indicating the seriousness of insider dealing. And third, this Section will building on the challenges identified in Step 1 highlight the challenges associated with Step 2.

The PRSID aims to deliver a deterrent,[534] and its computation is based on two fundamental factors, (i) insider dealing was referrable to an individual's employment, and (ii)

[533] M Minenna 'Insider trading, abnormal return and preferential information: Supervising through a probabilistic model' (2003) 27 Journal of Banking and Finance 59

[534] FSA (n 524), paragraph 3.10

insider dealing was not referrable to an individual's employment.[535] In cases where the insider dealing was referrable to an individual's employment, the figure for the purposes of Step 2 will be a figure based on a percentage of the individual's relevant income. According to DEPP 6.5C.2[G](4) an individual's relevant income will be the gross amount of all benefits received by him from the employment in connection with which the insider dealing occurred for the period of the insider dealing. Where the insider dealing lasted less than 12 months, or was a one-off event, the relevant income will be that earned by the individual in the 12 months preceding the final insider dealing. If the individual was in the relevant employment for less than 12 months, his relevant income will be calculated on a pro rata basis to the equivalent of 12 months' relevant income.[536] In determining the level of seriousness of insider dealing in cases when it is referrable to an individual's employment, the FCA uses 5 levels ranging between 0% to 40% (of the individual's relevant income) and a profit multiple between 0 and 4.[537] Insider dealing cases are normally considered by the FCA to be seriousness level 4 or 5, and set at £100,000,[538]

Level 1 – 0%, profit multiple of 0,

Level 2 – 10%, profit multiple of 1,

Level 3 – 20%, profit multiple of 2,

Level 4 – 30%, profit multiple of 3, and

Level 5 – 40%, profit multiple of 4

This fixed £100,000 penalty is different to the Sentencing Guidelines,[539] in that, the FCA considers every case of insider dealing to be worth imposing this hefty penalty. However, if looking at the actual cases as it was discussed in chapter three, it is rare that this fixed amount

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[535] DEPP 6.5C.2[G]. This reflects the FCA's view that where an individual has been put into a position where he can commit market abuse because of his employment the fine imposed should reflect this by reference to the gross amount of all benefits derived from that employment

[536] Ibid

[537] DEPP 6.5C.1[G] (6) and (8)

[538] DEPP 6.5C.2[G](2)(c)

[539] Sentencing Council, General guideline: overarching principles, step 2 Aggravating and mitigating factors

of £100,000 is imposed. In cases where the insider dealing was not referable to the individual's employment, the figure will be a multiple between 0 and 4 of the profit made or loss avoided by the individual for his own benefit, or for the benefit of other individuals where the individual has been instrumental in achieving that benefit.[540] The amount of a financial penalty is normally computed, justified by the FCA and reflected in its statement of policy in accordance with section 124 FSMA 2000.

As regards the factors indicating the seriousness of insider dealing, there are <u>four</u> of them as set out in DEPP 6.5C.2[G](10), namely,

(a) factors relating to the impact of the market abuse,

(b) factors relating to the nature of the market abuse,

(c) factors tending to show whether the market abuse was deliberate,

(d) factors tending to show whether the market abuse was reckless.

It is unclear whether there is any hierarchical division between these factors, but it appears that, the impact category is first amongst equals. The thesis believes it to be the case because insider dealing is about generating profits as it was indicated in footnotes 27 and 144. Also, even when the whole impact factor category is not determined, the FCA can probabilistically surmise that insider dealing could have caused an adverse impact on the market.[541] Although, there is no evidence on whether the other three categories of factors cannot be probabilistically presumed, it seems that the FCA will find it problematic to do. For example, the category 'tending to show whether the market abuse was deliberate'. In the case of Massey, the Upper Tribunal found him acting not in a deliberate manner, who 'by a process of wishful thinking persuaded himself on inadequate grounds that he was so entitled' to deal in the inside information he had had.[542] Can the prosecution probabilistically assume that a wrongdoer would have acted deliberately when he had not? Or would the end product of his actions have been different if he had in fact acted deliberately? Contestably, there is no difference for the financial markets as to whether the person who committed the insider dealing had done it intentionally or not, as they suffered or could have suffered some losses irrespective of the other three categories. Likewise, the 'nature

[540] DEPP 6.5C.1[G](7)

[541] FSA, Final Notice to Nicholas James Kyprios, NJK0I024, 13 March 2012, paragraphs 33, 34, 39, and 41

[542] *David Massey and The Financial Services Authority* [2011] UKUT FIN/2009/0024, para 54

of insider dealing category', if an insider is not an approved person, can the prosecution extend it to assuming him being an approved person? Certainly not, and therefore this category will not have a bearing on the behaviour of an outsider.

Therefore, this thesis will focus on the impact factor under DEPP 6.5C.2[G](11), with the other three categories of factors are provided in Appendix C. To note, the wording below preserves the original text of DEPP, so the term market abuse refers to insider dealing and market manipulation, these impact factors are,

* DEPP 6.5C.2[G](11)(a). The level of benefit gained, or loss avoided, or intended to be gained or avoided, either directly or indirectly,

* DEPP 6.5C.2[G](11)(b). Whether the market abuse had an adverse effect on markets and if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has bene damaged or put at risk

* DEPP 6.5C.2[G](11)(c). Whether the market abuse had a significant impact on the price of shares or other investments.

4.10.3. Step 3 - Aggravating and mitigating factors

At this stage, the FCA may ratchet up or reduce the amount of a financial penalty reflecting the seriousness of insider dealing arrived at Step 2 for mitigating and aggravating factors under DEPP 6.5C.3[G](2), and DEPP 6.2.1[G] on choosing between a financial penalty and public censure. This thesis will not delve into all these factors for they are not relevant for the purposes of this examination, but DEPP 6.5C.3[G](2)(b),

> (b) The degree of cooperation the individual showed during the investigation of the market abuse by the FCA, or any other regulatory authority allowed to share information with the FCA,

is interesting because for being co-operative an alleged insider is expecting a degree of leniency. Based on the issued Final Notices, the vast majority of civil cases, the individuals co-operated with either the FSA or the FCA, but in those cases where the individuals did not co-operate with the Authority(s), the penalties did not seem to have differed greatly. So, it is difficult to work out what would have the financial penalty been if the person had been un-cooperative. For future research on this particular factor, we suggest comparing this factor with

DEPP 6.2.1[G](2)(f), 'the nature and extent of any false or inaccurate information given by the person and whether the information appears to have been given in an attempt to knowingly mislead the FCA'.

4.10.4. Step 4 - Adjustment for deterrence

The FCA may adjust the figure arrived at after Step 3, if it believes that this figure is insufficient to deter the insider, or others, from committing further or similar insider dealing. According to DEPP 6.5C.4[G](1), there are three general circumstances in which the FCA will increase a penalty,

(a) where the FCA considers the absolute value of the penalty too small in relation to the market abuse to meet its objective of credible deterrence,

(b) where previous FCA action in respect of similar market abuse has failed to improve industry standards,

(c) where the penalty may not act as a deterrent in light of the size of the individual's income or net assets.

This Step will be thoroughly examined in the next chapter by examining deterrence theory, but it should be noted here that it is odd to place deterrence before step 5 on various penalty discount schemes. In chapter six, it will be shown that the PRSIDs have frequently been reduced at step 5.

4.10.5. Step 5 - Penalty discount schemes

DEPP 6.5C.5[G] together with DEPP 6.7 provide for discount for early settlement. Early settlement discounts are available only in cases where a settlement agreement, or focused resolution agreement, are reached during the period from commencement of an investigation until the FCA has, a sufficient understanding of the nature of the breach and communicated that assessment to the person concerned to reach an agreement.[543] A settlement agreement

[543] DEPP 6.7.3[G]

according to EG 5.1 is not out-of-courts but a regulatory decision. An individual and the FCA may agree the amount of any financial penalty, or the length of any period of suspension, restriction, condition, limitation, or disciplinary prohibition.[544]

According to DEPP 6.7.3[G](3) a settlement agreement reached during stage 1 will entail a 30 per cent reduction in the penalty, and 0 per cent in any other case. For a focused resolution agreement, where it is reached in relation to all relevant facts and all issues, a 30 per cent if the agreement is concluded during Stage 1, and 0 per cent in any other case. Where this agreement is reached in relation to all relevant facts, 15 to 30 per cent if the agreement is concluded during Stage 1, and 0 per cent in any other case, and any other circumstances 0 to 30 per cent if the agreement is concluded in during Stage 1, and 0 per cent in any other case.

Mention should be given to DEPP 6.5D, serious financial hardship under which a person if can verifiably prove that payment of a penalty will cause them serious financial hardship can expect a reduction in the proposed penalty.

4.11. Concluding remarks

This chapter aimed to answer questions (d), (e) and (f). In relation to question (d), it was argued that the notion of inside information, as one of the elements of the insider dealing offence creates several challenges to the FCA in the process of quantifying illegal gains from insider dealing. The quantification issue is based upon the following general problems, (1) the problems identifying inside information, (2) legal versus illegal insider dealing and (3) knowledge of insiders that they are in possession of inside information.

Regarding question (e) it was argued that today the FCA wields adequate powers to detect and enforce insider dealing, such as, the pre and post-trade transactions reporting, insider lists, suspicious transactions and orders reporting (STORs), persons discharging managerial responsibilities reporting, disclosure of inside information, whistleblowing, and market cleanliness statistics. These detection mechanisms are not without their shortcomings and limitations, but in combination they amplify the probability of detection thereby maintaining a credible deterrent threat.

[544] DEPP 6.7.1[G] and DEPP 6A

Notwithstanding that the FCA receives various intelligence, the number of investigations and prosecutions is small. There are currently 20 criminal investigations and 46 dual track investigations, and 23 investigation were closed during the financial year 2022/23.[545] At the same time, for example, the number of STORs received in 2022 was 3,367, which is many times greater the number of investigations opened by the FCA into insider dealing. It shows that the certainty of enforcement is relatively low partly due to the risk-based approach and scarce economic resources. As a result, the FCA aims to prosecute those insider dealing instances where there is a good likelihood of successful prosecution.

Concerning question (f). The focus of this chapter was on the civil regime's penalty-setting structure under DEPP. Each Step of the FCA's five-step penalty framework against individuals was examined, where it was argued that Step 1, i.e., disgorgement, as a financial penalty component is ambiguous in nature for the following reasons. First, disgorgement is not an indispensable component of a financial penalty. Second, when disgorgement is quantified it affects the financial penalty reflecting the seriousness of insider dealing through DEPP 6.5C.2[G](11)(a), that is, 'the level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the market abuse, either directly or indirectly'. Third, disgorgement can act as restitution in insider dealing cases. Fourth, the FCA cannot quantify illegal benefits from insider dealing with absolute certainty. All of that pointing to the possibility of imposing a financial penalty lower than the actual or quantified illegal gains. Fifth, disgorgement once quantified by the FCA is fixed, whereas the penalty reflecting the seriousness of insider dealing can be adjusted at steps 3, 4 and 5 of the framework.

To sum up, although the FCA is wielding legal powers to ensure that insider dealing regulations are effectively enforced, there is still a question as to how the civil regime against insider dealing that was introduced to complement the criminal regime, delivers deterrence. It is important to know because this chapter showed that whilst the certainty of detection is relatively high, the certainty of enforcement is low, therefore, those cases being enforced should radiate a strong deterrent effect. In the next chapter, this thesis will look into the theory of deterrence underpinning the FCA's approach to enforcement so as to understand whether deterrence is a suitable response to insider dealing, and whether the civil regime's penalty-setting framework is in conflict with the assumptions of a deterrence-based enforcement strategy.

[545] FCA, 'Operating service metrics 2022/23', 20 July 2023

CHAPTER FIVE

On Deterrence Theory and Enforcement of Insider Dealing Regulations

5.1. Introduction

This chapter will attempt to answer question two, is or can deterrence be a suitable response to insider dealing? The enforcement of insider dealing regulations in the UK is wedded to deterrence theory.[546] It will be interesting to explore how and what a deterrence-based enforcement strategy aims to achieve, what assumptions govern deterrence, how deterrence is measured and applied to the civil regime against insider dealing. Theoretically, the enforcement of insider dealing regulations is compatible with deterrence theory, but it will be shown that it is unclear whether the in-force penalty-setting framework of the civil regime is effective in propping up deterrence. The following hypothetical examples can illustrate the issue.

Imagine an enforcement environment wherein criminal convictions are imposed for each instance of insider dealing. Whilst it is true that every insider will be detected and sanctioned, the certainty of punishment does not specify the time-frame within which an insider is to be punished. As the swiftness criterion is omitted in this discussion, this example likewise glosses over this criterion assuming that it is impractical to investigate all potential cases of insider dealing at once, and, as a result, the swiftness criterion is embedded in the other two criteria. There is no guarantee, yet it is still possible, to catch insiders on their first violations, but the probability of this occurring is small, because there is no guarantee that the insider has not dealt in inside information before. Instead, without setting time constraints, it is expected that within the insiders' lifetimes they are going to have been convicted. Then, it can be anticipated that some insiders, being rational actors will refrain from dealing because the probability of being punished is one.

[546] DEPP 6.2.2[G](2)(b) and DEPP 6.5.2[G](1)

Another point to emphasise is as wealth climbs up any fear of imprisonment may dip leading the insider to becoming less risk averse.[547] Before being convicted the insider might have accumulated an n-amount of illegal gains from insider dealing which in the insider's opinion overshadowed the punishment. Similarly, if the insider was caught on their first violation, it would still be necessary to ascertain whether the insider dealing against which the prosecution was being under way was in fact a one-off event. Even if it was possible to prove beyond a reasonable doubt, it would still be impossible to measure the proportion of *one-off* violations to that of *continuous* violations in the total population of insider dealing instances. In other words, it would not be feasible to disentangle the one-off events from the continuous. Nonetheless, a criminal conviction is overall a potent deterrent. Common sense dictates that no sensible individual wishes to be put away in prison and classed as a criminal. Consider the next hypothetical example with the same enforcement environment but now every insider dealing will be sanctioned in accordance with the FCA's civil penalty-setting framework as discussed in chapter four. Similar to the previous scenario the catching of an insider leads to two outcomes, (i) the insider is apprehended on his first illegal dealing, and (ii) the insider has already generated some illegal benefits from the previous violations. In the former outcome, a monetary sanction is adjusted for deterrence and proportionality to the harm caused by the insider dealing. But what if the quantification of harm was incorrect, that is, the FCA cannot observe the actual illegal gains, i.e., the insider has hidden them away, or that the insider has already generated some illegal benefits from earlier insider dealing, which were not observed by the FCA. In both scenarios, the imposed financial penalty is lower than the actual illegal gains thereby diminishing deterrence. Of course, if the insider is an authorised or regulated person, the FCA can further to the financial penalty impose a disciplinary and/or administrative sanction thereby increasing deterrence.

The problem is that deterrence may be indeterminate. Gibbs opines that, 'deterrence is inherently unobservable and hence immeasurable',[548] then any deterrent-oriented enforcement strategy will be teetering on the brink of a setback, inasmuch as it will have no clearly set parameters against which this very strategy to be measured. This thesis positions deterrence as perceptible by virtue of internalising extra-legal costs and the indispensable theoretical

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[547] A J Chalfin and S Tahamont, *The economics of deterrence: a review of the theory and evidence* (1st edn, Routledge, 2018) 29, 31

[548] J P Gibbs, *Crime, Punishment and Deterrence,* (edn, Elsevier 1975), 13

framework of deterrence, the normative assumptions of rationality and ensuing from it the economic model of crime.[549] This position is built on two considerations.

First, people's attitudes toward risk and incentives vary between different types of crimes thereby setting the deterrence in insider dealing apart from other deterrence expectations, such as, crimes involving violence.[550] The very fact that deterrence can take on different shapes is telling as any deterrent model can turn out to be ineffective or effective depending on its components, such as, in-built expectations, internal and external conditions, model configurations, types of variables and set parameters. In brief, the existence of deterrence boils down to its components, take one component away or insert an additional value, both can significantly alter the deterrent model. As a result, deterrence exists, but it is a relative concept.

Second, in insider dealing regulations, the probability of detection does not explicitly differentiate between the criminal and civil regimes. But the severity does due to the differing consequences of respective sanctions, where the criminal sanction subsumes the civil or administrative sanctions. The severity criterion in insider dealing regulations ought to be the prevailing factor in view of the fact that the certainty of punishment is low. Amplifying the certainty of punishment would arguably lead to unbearable costs, so, as it will be seen, the severity of punishment should be proportionally raised. But while an imprisonment, or criminal conviction in general is found to be a powerful deterrent,[551] as Andenaes puts it, a severe sentence for a serious crime can ruin a life,[552] actually, even a less severe sentence can ruin lives,[553] a monetary sanction under the existing penalty-setting framework of the civil regime is abstruse.

Solving the quantification issue seems to be practically impossible because of the proving and corresponding computational obstacles. This problem will further be elaborated in

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[549] G S Becker, 'Crime and Punishment: An Economic Approach, (1968) 76 Journal of Political Economy 169

[550] A Chalfin and J McCrary, 'Criminal deterrence: a review of the literature', (2017) 55 Journal of Economic Literature 5; D S Nagin, 'Deterrence in the twenty-first century' (2013) 42 Crime and Justice in America 1975-2025 199

[551] Ibid

[552] J Andenaes 'The moral or educative influence of criminal law' (1971) 27 Journal of Social Issues 17

[553] T Chiricos, K Barrick, W Bales, and S Bontrager 'The labelling of convicted felons and its consequences for recidivism' (2007) 45 Criminology 547

chapter six, in which this thesis will put forward a two-step metric for computing the potential deterrent strength of a monetary sanction. The corollary of these two considerations delineates the scope of the present inquiry by allowing a deterrent-based enforcement strategy to be flexible and placing a greater emphasis on the severity criterion.

Deterrence theory rests on the assumptions of the axiomatised expected utility theory and transpiring from it the economic model of crime by Becker.[554] This model is at the heart of the discussion because it postulates that the decision to opt for a crime is similar to the decision to engage in legitimate economic behaviour. Thus, the model expects an individual to refrain from committing a crime if the potential costs of the crime are greater than the potential benefits.[555] In essence, it effectively chalks out the ultimate goal of a deterrent-based enforcement strategy which, as this thesis will argue, is to influence the costs-and-benefits of engaging in insider dealing, and not the proclivities for engaging in insider dealing.

5.2. Deterrence theory

5.2.1. Scope of deterrence

The mission of deterrence is to prevent future crime.[556] Preventing future crime is achieved through the three criteria of deterrence, the certainty, severity, and swiftness of punishment.[557] Where the certainty criterion is the probability at which an individual is detected, apprehended, and punished. The severity criterion is about determining the appropriate magnitude of punishment, which can be a monetary sanction, an administrative or disciplinary sanction, a criminal sanction, or a combination of all. The swiftness of punishment will only be touched

[554] Ibid

[555] Becker (n 549)

[556] C Beccaria, *An essay on crimes and punishments, A new edition corrected* (W.C. Little & Co, 1872), Chapter 12

[557] J Hampton, 'The Moral Education Theory of Punishment', (1984) 13 Philosophy and Public Affairs 208; R F Meier, and W T Johnson, 'Deterrence as Social Control: the legal and extra-legal production of conformity', (1977) 42 American Sociological Review 292, 293-94; K R Williams and R Hawkins, 'Perceptual research on general deterrence: a critical review' (1986) 20 Law and Society Review 544

upon in passing for it is assumed to be incorporated in the certainty and severity criteria.[558] To be clear, the swiftness of punishment is consequential. By observing this criterion would-be offenders may deduce that there is either a delay in punishment or the other way around prompt meting out of punishment. In either way, it is the certainty and severity of punishment which determine the level of deterrence, because if these criteria are weak, the swiftness criteria will not have any value on its own, only in conjunction with the other criteria.[559]

The certainty and severity criteria are in their turn contingent on the already meted out penalties.[560] The implication is that, if deterrence aims to reduce the incidence of crime, its improper maintenance will increase the incidence of crime by pushing the perception of risk downwards.[561] Therefore, it is important to draw inferences from an enforcement failure leading to deterrence ebbing away, and the expectations from the enforcement strategy. The latter should be looked at through the necessity of enforcing any given law, so, if the law 'serves a more valuable goal',[562] then there will an increase in enforcement, if the law is not trending, then there will not be an increase in enforcement, and maybe a decrease. The other stipulation is a high incidence of any given crime should not immediately insinuate a poor deterrent contribution. Because in order to know for sure the current deterrent rate the law in question should be repealed, and after that it will be possible to assess the past deterrent effect.[563]

Recall from chapter three, the enforcement of insider dealing regulations is warranted for two reasons. First, enforcement acts as a deterrent to those who committed the breach, this

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[558] See E S Howe and T C Loftus, 'Integration of Certainty, severity and celerity information in judged deterrence value: further evidence and methodological equivalence', (1996) 26 Journal of Applied Social Psychology 226; R Paternoster, 'The deterrent effect of the perceived certainty and severity of punishment: a review of the evidence and issues', (1987) 4 Justice Quarterly 173

[559] Nagin (n 550)

[560] T J Miceli, K Segerson and D Earnhart, 'The role of experience in deterring crime: a theory of specific versus general deterrence' (2022) 60 Economic Inquiry 1833

[561] R Paternoster, 'How much do we really know about criminal deterrence?' (2010) 100 Journal of Criminal Law and Criminology 765

[562] G S Becker and G J Stigler, 'Law Enforcement, Malfeasance, and Compensation of Enforcers' (1974) 3 The Journal of Legal Studies 1, 3

[563] J C Ball, 'Deterrence concept in criminology and law' (1955) 46 The Journal of Criminal Law, Criminology and Police Science 347, 350

is called specific deterrence.[564] Second, enforcement acts as a deterrent to those contemplating committing further or similar breaches, this is called general deterrence.[565] Largely, this chapter will concentrate on general deterrence because, (i) the certainty of punishment is low as it was argued in chapters three, four, and five, thence, (ii) when an insider dealing case is carried through its serves a broader purpose than merely penalising the person against whom the enforcement action has been brought, and for that reason (iii) these two types of deterrence can be interchangeable, i.e., a decrease or increase in deterrence after a penalty has been meted out is automatically conveyed to others.

Enforcement is costly.[566] For this reason, the FCA focuses on serious misconduct and chooses to enforce those cases exhibiting greater deterrence value.[567] Because the penalty resulting from a formal legal proceeding aims not only to act as the mechanism for changing the behaviour and preferences of the person in breach,[568] but also helps shaping the behaviour of others by sending out the deterrent message to would-be offenders.[569] This part on changing preferences is specious, as it contradicts the very assumptions of rational choice theory, hence deterrence, from which the enforcement of insider dealing regulations stems.[570] Not least, because some people will violate until it becomes too expensive for them.[571] That is, a deterrence-based enforcement strategy influences the costs and benefits of a criminal activity,[572] and not individuals' preferences.

In deterrence research, deterrence is usually measured using aggregate data research, perceptual research, or in insider dealing cases as it was discussed in chapter one, it relies on

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[564] Nagin (n 550)

[565] DEPP 6.5.2[G](1)

[566] G J Stigler, 'The optimum enforcement laws', (1970) 78 The Journal of Political Economy 3

[567] Enforcement Guide 2.2.9

[568] K Erta, S Hunt and Z Iscenko, 'Applying behavioural economics at the Financial Conduct Authority' (2013) FCA Occasional Paper 1

[569] Enforcement Guide 2.1.2(4)

[570] R D Luce and H Raiffa *Games and Decisions. Introduction and Critical Survey*, (Wiley and sons, 1957); A Porat, 'Changing People's Preferences by the State and the Law' (2021) 22 Theoretical Inquiries L. 215

[571] Becker and Stigler (n 562), 2

[572] Becker (n 549)

various economics variables. None of these methodologies is free of shortcomings. Mainly, current academic literature on deterrence in insider dealing laws investigates the impact of the first-time enactment of insider dealing legislation, or introduction of a new sanction.[573] Studies which evaluate or assess the role of regulations on the quantity of insider dealing oftentimes rely on the data prior and after the tightening of regulations, so they can be viewed as the snapshots of the past but not as the reflections of the present. If the incidence of insider dealing decreased after the enactment of new sanctions, this does not imply that this decrease would be remaining at a constant level throughout the life of the law. By applying the logic from the Lucas critique[574] to this problem will tell us that if the probability of enforcement and severity of punishment were at the lowest possible level, this would inversely affect this initial deterrent brouhaha potentially incentivising would-be offenders to commit insider dealing, and vice versa.

5.2.2. Certainty criterion

It is interesting that deterrence literature finds the certainty of punishment to be prevailing over the severity of punishment.[575] It is also confounding because the certainty of punishment is just

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[573] Bhattacharya and Daouk (n 21); R M Bushman, J D Piotrioski and A J Smith, 'Insider trading restrictions and analysts' incentives to follow firms', (2005) 60 Journal of Finance 35

[574] The Lucas critique states that the Phillips curve, i.e., shows a negative correlation between and unemployment, would not sustain if permanently raising inflation to permanently lower unemployment which would lead firms to downsize, or alter employment decisions, R E Lucas, 'Econometric Policy Evaluation: A Critique' (1976) 1 Carnegie-Rochester Conference Series on Public Policy 19

[575] A Witte, 'Estimating the economic model of crime with individual data' (1980) 94 Quarterly Journal of Economics 57, he individual data on the post-release activities of a random sample of 641 men who were in prison in North Carolina in 1969 and 1971; D J Pyle, *The Economics of Crime and Law Enforcement*, (the MacMillan Press Ltd., 1983); J Grogger 'Certainty vs Severity of punishment' (1991) 29 Economic Inquiry 297, a sample of 13,000 young male in California and D P Farrington, P A Langan and D P Farrington, *Crime and Justice in the United States and in England and Wales*, 1981-96, (Washington D.C., Bureau of Justice Statistics, 1998); H G Grasmick and D E Green 'Legal punishment, social disapproval and internalization as inhibitors of illegal behaviour' (1980) 71 Journal of Criminal Law and Criminology 325; C R Tittle *Sanctions and social deviance: the question of deterrence* (Praeger, 1980); S H Decker and C W Kohfeld, 'Certainty, severity, and the probability

a relationship, or a combination between detection, formal prosecution, and subsequent punishment. So, firstly, an offence must be detected, but this detection does not prescribe a formal investigation nor a penalty. Then, if the offence is detected and investigated, and the offender is apprehended, it does not still guarantee a penalty. It is only when all these three pieces come together they complete the certainty criterion.[576] To put it differently, without an appropriate punishment, the certainty criterion is incomplete, and maybe even deleterious to the deterrent effect as it will indicate that enforcement is sending weak deterrent signals to would-be offenders. In other words, when an imposed punishment is paltry, this also sends out the wrong message to would-be offenders resulting in undermined general deterrence and as a consequence wasted enforcement resources. Unison delivery of the certainty criterion is therefore not in itself a proof of deterrence. The literature suggests that by ratcheting up the certainty criterion, people will tend to refrain from breaching the law, but it is easy to walk into a trap of exaggerating deterrence by labouring under the misapprehension that people refrain from violating solely due to the certain legal threat, because this legal threat should not be derisory.[577]

Of course, sometimes the certainty can be more significant than the severity criterion, but this depends on types of offences being under consideration, and the nature of data being used.[578] There are at least two ways of demonstrating the importance of severity in insider dealing cases. For instance, an incorrigible drug addict craving for a dose will likely commit crime to finance their addiction regardless of the deterrence criteria. But an economically-driven offender is said can be deterred by the deterrence criteria,[579] especially by the severity

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of crime: A logistic analysis' (1990) 19 Policy Studies Journal 2; A N Doob and C M Webster, Sentence Severity and Crime: Accepting the Null Hypothesis, (2003) 30 Crime and Justice 143

[576] Hampton (n 557)

[577] L Han, S Bandyopadhyay and S Bhattacharya, 'Determinants of violent and property crimes in England and Wales: A panel data analysis' (2013) 45 Applied Economics 4820; S Decker, R Wright, and R Logie, 'Perceptual deterrence among active residential burglars: a research note' (1993) 31 Criminology 135; D S Nagin and G Pogarsky, 'An experimental investigation of deterrence: cheating, self-serving bias, and impulsivity' (2003) 41 Criminology 167

[578] L Friesen, 'Certainty of Punishment versus Severity of Punishment: An Experimental Investigation', (2012) 79 Southern Economic Journal 399, 400

[579] Nagin (n 550), 3; S Klepper and D Nagin, 'Tax Compliance and perceptions of the risks of detection and criminal prosecution', (1989a) 23 Law and Society Review 209; R Mason and L D Calvin, 'A study of admitted

of punishment given the offender is risk-averse.[580] Therefore, the deterrence criteria are able to influence the decision-making process of a would-be insider,[581] and consequently see improved standards of market conduct.[582]

Another way of reconciling the certainty and severity criteria by accepting Grasmick and Bryjak proposition that, '...people are more influenced by their perceptions of the certainty of arrest if they believe the penalty if arrested would be sever…'.[583] Therefore, the perceived severity of punishment does have a deterrent effect as the costs of committing a crime are increased.[584] The certainty and severity criteria are therefore should be in a positive symbiotic co-existence.[585]

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income tax evasion', (1978) 13 Law and Society Review 73; J Braithwaite and T Makkai, 'Testing an expected utility model of corporate deterrence', (1991) 25 Law and Society Review 7; A Von Hirsh, A E Bottoms, E Burney, and P O Wilkstrom, 'Criminal Deterrence and Sentence Severity: An Analysis of Recent Research', (2001) 39 Alberta Law Review 597; S H Kadish, 'Some observations on the use of criminal sanctions in the enforcement of economic regulations', (1977) in G Geis and R F Meier eds, *White collar crime: offences in business, politics, and the professionals*, (Free Press, 1977), 304

580 W J Chambliss 'The deterrence influence of punishment' (1966) 12 Crime and Delinquency 70

581 S M Mendes, 'Certainty, Severity, and Their Relative Deterrent Effects: Questioning the Implications of the Role of Risk in Criminal Deterrence Policy' (2004) 32 Policy Studies Journal, 59

582 DEPP 6.2.2[G](2)(b)

583 H G Grasmick and G J Bryjak, 'The deterrent effect of perceived severity of punishment' (1980) 59 Social Forces 47, 486

584 W C Bailey and R P Lott 'Crime, punishment and personality: An examination of the deterrence question' (1976) 67 Journal of Criminal Law and Criminology 99

585 W C Bailey and R W Smith, 'Punishment: Its Severity and Certainty', (1973) 63 Journal of Criminal Law and Criminology 530, 531 Also see M K Block and V E Gerety, 'Some Experimental Evidence on Differences Between Student and Prisoner Reactions to Monetary Penalties and Risk' (1995) 24 Journal of Legal Studies 123, 138

5.2.3. Severity criterion: principle of proportionality and marginal deterrence

The magnitude of punishment is determined by two considerations, (i) a punishment ought to be proportional to the gravity of crime, and (ii) the costs from committing a crime should outweigh the benefits accruing from the crime.[586] The principle of proportionality implies that there should be a fixed proportion between crime and punishment.[587] In the words of Hart, the punishment must 'fit the crime'.[588] The logic for the principle of proportionality is that a punishment should not compromise marginal deterrence.[589] Marginal deterrence can be summarised by Bentham's Rule 3 and Rule 4, '[w]hen a man has resolved upon a particular offence, the next object is, to induce him to do no more mischief than what is necessary for his purpose'.[590]

As an illustration, given the low level of certainty, consider a criminal punishment that does not discriminate between the gravity of insider dealing. Moreover, for the sake of this example, the quantified illegal benefits is the prevailing factor determining the harm of insider dealing, so any other aggravating factors are inferior. An insider generates £10,000, and the punishment is five years in prison. Another insider generates £1,000 and receives the same punishment of five years in prison. What it means is that other would-be offenders contemplating this disproportionate imposition of punishment would likelier commit more often and/or egregious offences so as to bring their illegal benefits as close as possible to maximising their utilities. Therefore, a penalty should be proportionate to the gravity of insider dealing. All things being equal, a £1,000 in illegal gains should be punished differently to a £10,000 in illegal benefits.

The Enforcement Guide as well as DEPP lay out the circumstances and factors in which the FCA will likely commence a criminal prosecution or opt for the civil route. By

[586] Beccaria (n 556)

[587] Ibid, Chapter VI

[588] H L A Hart, *Punishment, and responsibility*, (Clarendon Press, 1968), 160

[589] Beccaria (n 556) 32

[590] J Bentham, *An introduction to the principles of morals and legislation*, (Oxford Clarendon Press, 1907)

differentiating the gravity of insider dealing the FCA thereby aims to target perceptions of marginal deterrence. If this difference between the regimes is preserved an increase in punishment is perceived by would-be offenders.[591] However, there is one issue springing up from this differentiation between the regimes.

It is deemed that the imposition of criminal liability for harmful conduct bears more deterrence than that of civil liability.[592] It means that that the idea of marginal deterrence is not that pronounced in the civil regime, because any quantified figure representing illegal gains can be incorrect. Whatever reason might throw this quantification out, the task of ensuring the proportionality of punishment remains for the FCA. Should the quantification be incorrect, then a penalty can produce a negative effect on deterrence by being disproportionately low. While, a criminal conviction is a deterrent,[593] a deterrent effect from a civil financial sanction is more problematic to deduce because here a monetary illegal benefit is set against a monetary sanction, and possibly other administrative or disciplinary sanctions should the insider be an authorised or regulated person. As far as a monetary sanction is concerned, rational decision making in its normative sense prescribes an individual to choose an option that gives the highest utility.[594] So, if a monetary sanction is lower than the actual amount of illegal gains, then given the low certainty of enforcement, a rational person would commit insider dealing. In that case, when a penalty is disproportionately small thus weakening a potential deterrent effect.

To note, the Proceeds of Crime Act 2002 was enacted specifically to eliminate the possibility of multifarious offenders to hide away their criminal proceeds to be enjoyed by their

[591] F E Zimring and G J Hawkins, *Deterrence – the legal threat in crime control* (University of Chicago Press, 1973), 142

[592] J Arlena and L A Kornhauser, 'Does the law change preferences?' (2021) 22 Theoretical Inquiries in Law 175, 176

[593] S D Levitt 'Why Do Increased Arrest Rates Appear to Reduce Crime: Deterrence, Incapacitation, or Measurement Error?' (1998) 36 Economic Inquiry 353 ; D Kessler S D Levitt 'Using Sentence Enhancements to Distinguish Between Deterrence and Incapacitation' (1999) 42 Journal of Law and Economics 343

[594] Becker (n 549), see also M Friedman and L Savage, 'The expected utility hypothesis and the measurability of utility' (1952) 60 Journal of Political Economy 463; M Rabin, 'Psychology and economics' (1998) 36 Journal of Economic Literature 11; G S Kavka, 'Rational maximising in economic theories of politics', *in the Economic approach in politics: a critical reassessment of the theory of rational action*, eds K R Monroe (Harper Collins, 1991); W H Riker, 'Political science and rational choice', in *Perspectives on positive political economy*, eds J E Alt and K A Shepsle, (CUP, 1990)

families or once they have been released. The point is, if an insider comes out to a wealthy lifestyle irrespective of whether it is a prison term or a financial sanction, it shows the quantification issue by contradiction.

This problem of deterrence exists, if and only if deterrence exists in the first place.

5.2.4. Existence of deterrence

The effectiveness of regulations comes down to measuring deterrence from enforcement. For if there is no deterrent effect, then a deterrence-based enforcement strategy will not be effective. Heretofore, deterrence research primarily used aggregate data to locate deterrence.[595] Deterrence in such studies is measured by correlating the number of arrests and/or convictions/penalties of any given type of offence and its respective incidence.[596] So, the number of arrests and/or convictions is divided by the number of reported crimes. Mere correlation between legal sanctions and crime rates is not ample to research insider dealing. As any decrease in crime can reflect at least three causes, (1) the decrease in crime rates is attributable to deterrence, (2) the decrease in crime rates is not attributable to deterrence, and (3) some of the decrease in crime rates is attributable to deterrence.[597] Ascertaining which cause is predominant is difficult, inasmuch as scarcely anybody can learn the exact number of criminal opportunities which have been taken advantage of or passed up. Recall from the analysis on the market cleanliness statistics and suspicious transactions and orders reports, which act as the indicators of the quantity of potential insider dealing, the total number of reported alleged insider dealing is many times greater than the enforced cases, to say nothing of unreported and undetected cases of insider dealing. Going by aggregate data alone in insider dealing would depict a reality where the certainty of punishment is near zero, and the severity of punishment is thereby undetermined.

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[595] Nagin (n 550)

[596] R Paternoster, 'Examining three-wave deterrence models: a question of temporal order and specification' (1988) 79 Journal of Criminal Law and Criminology 135; G Antunes and A L Hunt 'Certainty and Severity of punishment', 381, in *Justice and Corrections*, ed. N B Johnston and L D Savitz (John Wiley and Sons, 1978)

[597] Ibid, 295

Another conspicuous drawback of aggregate data research is that it does not take into account individuals' perceptions.[598] Thus, individuals' attitudes towards risk and/or uncertainty are not recognised.[599] Overcoming this impediment is done by perceptual deterrence research. Prominent scholars, such as, Andenaes,[600] Gibbs[601] and Zimring and Hawkins[602] opine that the certainty criterion is not the objective risk, i.e., not the formal statute defining the punishment, but it is about an individual's perception of certainty.[603] To put it differently, the legal threat does not exist until an individual perceives that risk.[604]

One of the most used studies in perceptual deterrence research is the measuring of people's perceptions by exploring their past behaviour and respective outcomes, and the behaviours and outcomes of others.[605] This way of locating deterrence cannot also incontrovertibly prove the existence of deterrence in insider dealing regulations for several reasons. First, because of the dual-regulatory framework a study researching perceptions of insiders or would-be insiders will have to choose variables distinctly differentiating between the sanctions of regimes or conduct an analysis for the regimes separately so as not to confuse the respondents. Second, is the problem of temporal order.[606] Consider this example, an insider

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[598] D F Greenberg, R C Kessler, and C H Logan, 'Aggregation bias in deterrence research: an empirical analysis' (1981) 18 Journal of Research in Crime and Delinquency

[599] T C Shelling, *Micromotives and macrobehaviour*, (W. W. Norton. 1978), 142

[600] J Andenaes, *Punishment and Deterrenc*e, (Ann Arbor: University of Michigan Press, 1974), 52

[601] Gibbs (n 548) 115

[602] Zimring and Hawkins (n 591), 157

[603] S Ekland-Olson and W R Kelly 'Justice and Pressure', in *Research in Criminology* ed. A Blumstein and D P Farrington, (Springer-Verlag, 1993). J P Gibbs 'Law as a means of social control' 83, in *Social Control: views from Social Sciences*, ed. J P Gibbs, (Sage Publications, 1982)

[604] Gibbs (n 548) 7

[605] L Lochner, 'Individual Perceptions of the Criminal Justice System', (2007) 97 American Economic Review 444, 445; J L Teevan Jr, 'Subjective perceptions of deterrence (Continued)' (1976) 13 Journal of Research in Crime and Delinquency 155

[606] R Paternoster, 'Three-wave deterrence models: a question of temporal order and specifications' (1988) 79 Journal of Criminal Law and Criminology 135; L Saltzman, R Paternoster, G P Waldo, and T G Chiricos, 'Deterrence and experiential effects: the problem of causal order in perceptual deterrence research', (1982) 19 Journal of Research in Crime and Delinquency 172

is caught, and the FCA is able to prove that in addition to the insider dealing for which the insider is being penalised, the insider had committed insider dealing four and two years ago too but did not commit insider dealing in the years between the aforementioned. The question is what caused the insider to violate in the years four and two preceding the apprehension, but not in the years three and one? Delving deeper exposes another obstacle to perceptual deterrence research for insider dealing regulations, at least in the UK.

According to the Final Notices issued by the FSA and subsequently the FCA against civil insider dealing, predominantly all the enforced cases were one-off insider dealing events. So, the insiders would not have any past experiences to draw on. A counter-argument to this critique is that there was nothing preventing the insiders from learning from the experiences of others.[607] This is why the knowledge and awareness of insider dealing laws including the outcomes of enforced cases is of paramount significance for the deterrent framework.[608]

This possibility lays bare two fundamental points, such as (1) knowledge of laws and (2) extra-legal and vicarious costs. Regarding the knowledge point. Knowledge of the laws acts as a deterrent to would-be offenders.[609] If people are not aware of prohibition then surely there cannot be any deterrent effect until the prohibition is enforced.[610] Then, if the prohibition is advertised so that people are made familiar with it, their perceptions, that is, beliefs can be influenced by manipulating the costs and benefits from crime.[611] Including through the negative experiences of others,[612] which is part of social learning.[613] This learning process is subject to

[607] R L Henshel and S Carey, ‘Deviance, deterrence and knowledge of sanctions’ (1975) in R Henshel and R Silverma, *Perception in Criminology* (Columbia University Press, 1975), 127

[608] J Hoggett, Speech by Director of Market Oversight at the FCA, at the AFME Implementation of the Market Abuse Regulation in the UK event, London, 2019

[609] T G Chiricos, and G P Waldo, ‘Punishment and crime: An examination of some empirical evidence’ (1970) 18 Social Problems 200; P H Robinson, 'The difficulties of deterrence as a distributive principle' (2015), 104, in eds. P H Robinson, S Garvey, and K Ferzan, *Criminal Law Conversations*, (Oxford Academic, 2015)

[610] Ball (n 563), 351

[611] D Kahan, ‘Social Influence, Social Meaning, and Deterrence’ (1997) 83 Vanderbilt Law Review 349

[612] L Lessig, ‘Social Meaning and Social Norms’, (1996) 144 University of Pennsylvania Law Review 2181

[613] A Bandura *Social learning theory* (Prentice Hall, 1977), 117

Bayesian updating, i.e., people revise their behaviour as new information comes in.[614] For example, an insider is caught in the conditions of low certainty of enforcement. Others, including would-be insiders, are informed about the case and they follow the progress of the case. After a while, this insider gets off scot-free, or is penalised by a minimal fine. This outcome will shape the perceptions of would-be insiders about deterrence, as people observe deterrence experientially or vicariously.[615] In other words, if this weak enforcement patterns are consistent, this will eventually bring the deterrent threat to zero, as would-be insiders would *vicariously* live through the experiences of others.[616]

In the optimal enforcement and sanctions section down in the chapter, it will be argued that to make up for the low level of certainty of punishment,[617] and to maintain the deterrent threat, it is justifiable to punish some offenders more severely.[618] When would-be insiders refer to the publicly available statistics, such as market cleanliness and the like, they observe low enforcement rates demonstrating the inability of the FCA to act on every case due to enforcement costs and other regulatory responsibilities. What it also points to is that many insiders have in fact avoided being punished, which can facilitate future offending.[619]

Deterrence is not easily located, and there is always 'a complicated interplay between the law and the multitude of other factors which shape our attitudes and behaviour'.[620] Paternoster and others, argue that the legal threat decreases if additional factors are included in

[614] S Lichtenstein, P Slovic, B Fischhoff, M Layman and B Combs 'Judged frequency of lethal events' (1978) 4 Journal of Experimental Psychology: Learning, Memory, and Cognition 551

[615] M C Stafford and M Warr, 'A reconceptualization of general and specific deterrence', (1993) 30 Journal of Research in Crime and Delinquency 123

[616] T Hornle, 'Foundational Texts: P.J.A. von Feuerbach and his textbook of the common penal law (1801)', (2013) M. Dubber (ed) *Foundational Texts in Modern Criminal Law*, (OUP, 2014)

[617] A von Hirsh, 'Proportionality in the philosophy of punishment', (1992) 16 Crime and Justice 55

[618] J G Murphy, 'Marxism and Retribution' (1973) 2 Philosophy and Public Affairs 217, 218, 219; W Cragg, 'H L A Hart and the Justification of Punishment', (1992) V Canadian Journal of Law and Jurisprudence 43

[619] W Minor and J Harry 'Deterrent and experiential effects in perceptual deterrence research: A replication and extension' (1982) 19 Journal of Research in Crime and Delinquency 190

[620] Andenaes (n 552); G Tullock 'Does punishment deter crime' (1974) 36 The Public Interest 103

the decision-making process,[621] but this thesis on the contrary deems that deterrence will mean any inhibition of crime brought about directly or indirectly by the threat of legal sanctions.[622] As Wilson and Herrnstein put it: '[t]he bite of conscience, the approval of peers, and any sense of inequity will increase or decrease the total value of crime; the opinions of family, friends, and employers are important benefits of non-crime, as is the desire to avoid the penalties that can be imposed by the criminal justice system'.[623] This serves as a departure point for exploring the assumptions of rationality defining the expectations of a deterrence-based enforcement strategy.[624]

5.3. Rationality

This section will focus on the normative assumptions of rationality underpinning deterrence theory.

5.3.1 Scope of discussion

Although, the FCA's approach to enforcement is premised on the concept of rational behaviour, it has been gingerly acknowledged that the findings from behavioural economics can deepen

[621] R Paternoster, L E Saltzman, G P Waldo, and T G Chiricos, 'Perceived risk and social control: do sanctions really deter?' (1983b) 17 Law and Society Review 457; R Paternoster and L A Iovanni, 'The deterrent effect of perceived severity: a reexamination' (1986) 64 Social Forces 751

[622] Williams and Hawkins (n 557)

[623] J Q Wilson and R Herrnstein, *Crime and Human Nature*, (Simon & Schuster, 1985), 61

[624] FCA, 'Behaviour and compliance in organisations' (2016) Occasional paper 24, 5. Policymakers are often base their expectations on the concept of rationality M S Barr, S Mullainathan, and E Shafir, 'The Case for Behaviourally Informed Regulation', in New Perspectives on Regulation, The Tobin Project, edited by D Moss and J. Cisternino, (2009) 25; D B Cornish and R V Clarke, *The Reasoning Criminal: Rational Choice Perspectives of Offending*, (Springer-Verlag, 1986); I Piliavin, R Gartner, C Thorton and R Matsueda, 'Crime, Deterrence and Rational Choice', (1986) 51 American Sociological Review 101

the enforcement practice.[625] People do not respond to incentives in a strictly rational way,[626] was the conclusion from the FCA's occasional paper, where the credible deterrence approach aims to change persons' preferences that will change the way people respond to incentives, i.e., it will influence the costs and benefits of crime.[627] A practical example was given with respect to widespread violations of competition law in spite of heavy penalties.[628]

There are two fundamental flaws with the reasoning of above statements. First, the example with competition violations can barely hold water inasmuch as while it is possible that not everyone responds to incentives, some people do respond, and it can mean that the more severe sanctions are in fact not that severe compared to the potential gains, and/or the certainty of punishment may have been low, or both, and some people will always violate in defiance of punishment. Second, the aim of credible deterrence approach is to change persons' preferences is an overweening ambition since it is necessary to define what a preference is in relation to insider dealing. Is it the insider dealing's profitability or the possibility of avoiding losses that determine these preference relations? It is correct that the credible deterrence approach strives to change behaviour, but not through modifying people's preferences.[629] It is an individual's risk attitudes and perceptions of costs and benefits ought to be affected, i.e., beliefs, not preferences.[630] People's preferences according to the normative rational behaviour are stable, but beliefs of the costs and benefits can be manipulated by altering the consequences of those choices.[631]

This thesis evaluates the enforcement rates as not high or low, but through the potential deterrent effects stemming from the imposed sanctions. Where the purpose of any sanction is

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[625] Z Iscenko, C Pickard, L Smart, and Z Vasas, 'Behaviour and compliance in organisations' (2016) FCA, OP 24 and K Erta, S Hunt and Z Iscenko, 'Applying behavioural economics at the Financial Conduct Authority' (2013) FCA's Occasional Paper 1

[626] Ibid

[627] Erta and others (n 568)

[628] Ibid

[629] D Z Lewinsohn, 'The Importance of Being Earnest: Two Notions of Internalization', (2005) 65 University of Toronto Law Journal 37

[630] S Bowles, 'Endogenous Preferences: The Cultural Consequences of Markets and Other Economic Institutions', (1998) 36 Journal of Economic Literature 75; Arlena and Kornhauser (n 585)

[631] Ibid, 178

to deliver deterrence by manipulating people's costs and benefits of insider dealing, and not their preferences over insider dealing! In doing so, it will be possible to observe deterrence as would would-be offenders when looking at the Final Notices.[632] The enforcement of insider dealing should remain as certain and severe as people's overall desire to maximise utility. Should this preference-relation be changed it could lead to a number of uncertainties, such as, (i) the whole concept of rationality underpinning deterrence can disappear,[633] (ii) both illegal and legal insider dealing will coalesce into each other to the point of being undistinguishable, hence (iii) legitimate aspirations for economic growth will be reconfigured.

Why do the normative version of rational choice define deterrence theory?[634] Rationality does not mean sensibility, but it is the ability of an individual to weigh up the consequences of their actions or preference relations, where this weighing up is carried out on the back of a cost-and-benefit analysis directed at utility maximisation.[635] The axioms of expected utility theory, to be discussed later in this chapter, are mathematically elegant for characterising various types of people's behaviours in terms of the utility function.[636]

Furthermore, the normative theory of rational behaviour underpinning deterrence is justified for the following analytical reasons,

Reason 1: for conceptual clarification of how to define rational behaviour in various social situations,

Reason 2: for explanation and prediction of people's actual behaviour (in cases in which their behaviour exhibits high degrees of rationality and therefore admits of explanation in terms of a rationalistic theory),[637]

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632 Lessig (n 612); Bandura (n 613)

633 Arlena and Kornhauser (n 592)

634 T A Loughran, R Paternoster, A Chalfin, and T Wilson 'Can rational choice be considered a general theory of crime? Evidence from individual-level panel data' (2016) 54 Criminology 86; J Stiglitz, 'Regulation and Failure', in *New Perspectives on Regulation*, edited by D Moss and J Cisternino, (1st edn, The Tobin Project 2009), 17

635 Nagin (n 550) 205, Becker (n 549) 177, 178; R M Dawes, *Rational choice in an uncertain world* (Harcourt Brach Jovanovich, 1988); C Herrmann-Pillath 'Evolutionary rationality, 'Home economicus', and the foundations of social order' (1994) 17 Journal of Social and Evolutionary Systems 41

636 M J Machina, 'Expected utility analysis without the independence axiom' (1982) 50 Econometrica 277

637 J C Harsanyi, *Rational behaviour and bargaining equilibrium in games and social situations*, (CUP, 1977)

Reason 3: for providing heuristic criteria for (nonrationalistic) explanatory and predictive theories of social behaviour (even in cases where this behaviour deviates from the normative concept of rationality),

Reason 4: for providing a descriptive standard of evaluation by which to judge the rationality of people's behaviour,[638]

Reason 5: insiders are rational actors because they deliberate over the consequences of their actions.[639]

The normative approach to rationality has been criticised by the descriptive theories of rational choice.[640] This thesis will not delve into this debate as it falls beyond the scope of discussion, but two propositions from descriptive theories should be highlighted, namely, bounded rationality and loss aversion. People systematically exhibit biases in their calculations,[641] that is, people are not perfect information processors,[642] so, even if people act in a rational way their rationality is bounded.[643] In other words, people tend to perform limited searches, do not engage mathematically in assessing options, and are disposed to accept the first satisfactory decision.[644] But for the purposes of insider dealing it should be said that people

[638] Ibid, 19

[639] R Bachman, R Paternoster, and S Ward 'The rationality of sexual offending' (1992) 26 Law and Society Review 343; Hampton (n 552) 210

[640] D Ellsberg 'Risk, ambiguity. and the savage axioms' (1961) 75 Quarterly Journal of Economics 643; D Kahneman and A Tversky 'Prospect theory: An analysis of decision under risk' (1979) 47 Econometrica 263

[641] D S Nagin and R Paternoster 'Personal Capital and Social Control: The Deterrence Implications of a Theory of Individual Difference in Criminal Offending' (1994) 32 Criminology 581; G Pogarsky 'Deterrence and Individual Differences among Convicted Offenders' (2007) 23 Quantitative Criminology 59

[642] G J Stigler 'The economics of information' (1961) 69 Journal of Political Economy 69. 213, 215; A Tversky and D Kahneman, 'Rational choice and the framing of decisions', (1986) 59 Journal of Business S251; P J H Schoemaker, 'The expected utility model: its variants, purposes, evidence, and limitations', (1982) 20 Journal of Economic Literature 529

[643] R H Thaler, *Misbehaving: The Making of Behavioural Economics*, (W.W. Norton, 2015)

[644] H A Simon 'A behavioural model of rational choice' (1955) 69 Quarterly Journal of Economics 99

may be not perfect Bayesians or perfectly rational individuals, but they are sufficiently rational to tell the differences between incentives and disincentives.[645]

The notion of loss aversion comes from prospect theory, which is a descriptive model of decision making proposed by Kahneman and Tversky.[646] In prospect theory, the utility function is replaced by the value function, which is concave in the domain of gains and convex in the domain of losses. This shape of a curve tells us that individuals become risk takers when facing loses, and they are inclined to be risk averse when facing profits.[647] The utility function of normative expected utility theory, to be examined in the next Sections, cannot explain an abrupt switch from risk aversion to risk seeking.[648] In relation to insider dealing it can mean that when insiders face loses, although they are initially risk averse, they can turn to becoming risk takers.

5.3.2 Decisions under risk and uncertainty

Any decision taken by people are subject to certainty, uncertainty, and/or risk. Decisions to commit crime are usually made in the conditions of risk and uncertainty. In decisions under risk objective probabilities are known to the decision-maker, i.e., there is a set of possible outcomes each occurring with a known probability.[649] For example, a lottery ticket offering known prizes.[650] In another example the reader will be asked to make a decision. There is fair coin to be flipped. If a head comes up on the first toss a £100 is awarded if a tail comes up on the first toss £60 is taken away. Would the reader play that gamble? And, if yes, how many times? Risk is thus related and can be ascribed to the potential rewards, where such rewards

[645] D M Kennedy, *Deterrence and Crime Prevention: Reconsidering the Prospect of Sanction*, (eds, Routledge 2008), 15, 23

[646] A Tversky and D Kahneman, 'Loss Aversion in Riskless Choice: A Reference-Dependent Model' (1991) 106 Quarterly Journal of Economics 1039

[647] Ibid

[648] D Kahneman, 'Maps of Bounded Rationality: Psychology for Behavioural Economics' (2003) 93 The American Economic Review 1449

[649] Luce and Raiffa (n 570)

[650] Harsanyi (n 637)

can be from a crime.[651] Decisions under uncertainty are somewhat similar to that of risk, but here the decision maker possesses incomplete information about the outcomes, but it does not mean that these objective probabilities do not exist.[652] For example, betting on a horse is a decision under uncertainty because the decision maker cannot know the probabilities of which horse will end up winning.[653] Insider dealing is also a decision under uncertainty and risk for two reasons. First, the insider does not know the probabilities of whether they will be detected, apprehended, and punished. Second, an insider benefits by transforming uncertainty (uninformed investors are making decisions under uncertainty) into more profitable risks, whilst simultaneously the steps are taken to reduce a probability of punishment.[654]

Becker in his model of economic crime postulates that deterrence depends on an individual preference for risk.[655] People can be risk averse, risk takers, or risk neutral. Risk averse actors prefer a second-order stochastically dominant gamble to a dominated one, i.e., a sure gain over a positive gamble.[656] For example, there are two gambles, *x* and *y*, where *x* involves less risk and offers at least the same satisfaction as y, the decision-maker will choose *x* over *y*. If the decision maker is indifferent between these two gambles, he is risk neutral. As it will be seen, risk *a*ttitudes are measured by observing the curvature of a utility function, but they can also be inferred from people's decisions.[657]

This thesis will concur with the study of Geis and Szockyj and regard insiders as risk averse actors.[658] But this risk attitude is not constant and is subject to change with (i) the level of deterrence criteria, that is, insiders' costs and benefits perceptions can be manipulated, and

[651] Kennedy (n 645)

[652] A Tversky and D Kahneman, 'Advances in prospect theory: Cumulative representation of uncertainty' (1992) 5 Journal of Risk and Uncertainty 297

[653] Harsanyi (n 637)

[654] J C Coffee Jr., 'No Soul to Damn - No Body to Kick - An Unscandalised Inquiry into the Problem of Corporate Punishment' (1981) 79 Michigan Law Review 386

[655] Becker (n 544)

[656] Tversky and D Kahneman (n 652), 306

[657] F P Ramsey, *The Foundations of Mathematics, and other Logical Essays*, (Routledge, 1931); B de Finetti, 'Foresight: Its logical laws, its subjective sources' (1937) 7 Annales de l'Institut Henri Poincare 97

[658] G Geis and E Szockyj, 'Insider Trading Patterns and Analysis', (2002) 30 Journal of Criminal Justice 273

(ii) the level of wealth.[659] It will be acknowledged that diminishing marginal utility, i.e., decreasing risk aversion can affect insiders decision making and influence a deterrence-based enforcement strategy.[660]

5.3.3 Expected utility theory

Discussing the economic model of crime requires an understanding of expected utility theory and its axioms. Expected utility theory is a normative theory of choice formulating rational decision making for decisions involving risky and/or uncertain options, and it does not claim to be a descriptive theory.[661] Mathematically speaking, a decision maker assigns a real number to each alternative so that, for any two alternatives, one is preferred to the other if and only if the utility of the first is greater than the utility of the second.[662] The classical model of expected utility theory, to be discussed below, is not axiomatised, and deals with risk neutral situations, i.e., it is linear in probabilities and defined over final levels of wealth.[663] A Bernoulli utility function, is a relationship that maps x to $u(x)$. To note, a relation to be represented by a utility function should be a rational preference relation, which can be simply represented by a utility function $u : X \rightarrow \mathbb{R}$, *where* $x \succcurlyeq y \Leftrightarrow u(x) \geq u(y)\ \forall x, y \in X$. In the next section on the axioms of expected utility theory the notion of risk aversion is included which makes a utility function concave downwards.[664] So, the decision maker chooses between two alternatives, which are mutually exclusive. The decision maker's preference relation can be represented by,

- Strict preference relation, $x \succ y \Leftrightarrow [x \succcurlyeq y$ and $y \neq x]$
- Weak preference relation, $x \gtrsim y$, i.e., x is preferred at least as y, or indifferent

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[659] W Brown and M O Reynolds 'Crime and 'Punishment': Risk Implications' (1973) 6 Journal of Economic Theory 508

[660] Knowing a person's utility function and by using the Arrow-Pratt equation it is possible to compute that person's risk aversion given any changes to risk with increasing or decreasing wealth, W J W Pratt, 'Risk aversion in the small and in the large' (1964) 32 Econometrica 122

[661] J Marschak 'Rational behaviour. uncertain prospects. and measurable utility' (1950) 18 Econometrica 111

[662] P C Fishburn, *Utility theory for decision making*, (John Willey & Sons, 1970)

[663] Ibid

[664] M J Kochenderfer, *Decisions Making under uncertainty, theory and application* (MIT Press, 2015)

- Indifference, $x \sim y \Leftrightarrow [x \succcurlyeq y$ and $y \succcurlyeq x]$

The preference relation is rational if it possess the following two properties, it is complete and transitive.

- Completeness: for all $x, y \in X$, we have that $x \gtrsim y$ or $y \gtrsim x$ (or both)
- Transitivity: for all $x, y, z \in X$, if $x \gtrsim y$ and $y \gtrsim z$, then $x \gtrsim z$

Finally, there is a difference between the expected value and the expected utility. The former simply tells the decision maker to choose an option with the highest value. For instance, given decreasing marginal utility, £10,000 for a student has much a greater value than to a businessman having £1,000,000.[665] Marginal utility decreases as the amount of benefit increases. Another example, consider this student needs £10,000 to pay for tuition, and the student has exactly £10,000. Then, a dealer turns up and offers a gamble in which if a head comes up the student wins £15,000, if a tail comes up the student loses £1,000. The expected value of future expected wealth is £25,000 which larger than the current wealth of £10,000, but if the student loses the bet, with the wealth of £9,000 the student will be expelled which will result in the student not being able to find a job. A mere higher expected value does not account for other considerations.

5.3.4 Axiomatised expected utility theory

Von Neumann and Morgenstern (hereinafter the VNM) devise several constraints to help the decision maker with their preferences on the objective risks, so that a utility function encapsulates risk attitudes and maximises utility.[666] Plainly speaking, the VNM version of expected utility theory constructs preferences on the lotteries, *L*, which can be anything, for instance, the decision marker's preferences on the prizes. Preferences according to this model are defined not over final wealth, but over a domain of *L*. The VNM theorem states that, under the axioms of completeness, transitivity, continuity and independence, a decision maker making a decision under risk will behave as if he is maximising the expected value of utility.

[665] Thaler (n 643)

[666] J Von Neumann and O Morgenstern, *Theory of games and economic behaviour*, (Princeton UP, 1944)

The continuity axiom states that small changes in probabilities do not change the nature of the ordering between <u>two</u> alternatives, it implies the existence of a VNM utility function U: $A \rightarrow \mathbb{R}$, such that $L \gtrsim L'$ if and only if $U(L) \geqslant U(L')$. The difference between the classical expected utility function and the VNM is that, in the former the decision maker assigns a numerical value to each element in X, a set of alternatives, and ranks them according to his preferences. In the VNM model, the VNM utility function maps from the space of lotteries to real number as it represents the preference defined on the lottery space.

Deterrence models generally predict compliance patterns based solely on the subjective probability and utility of outcomes associated with alternative actions.[667] The VNM expected utility model deals with first-order probability distributions over outcomes, so it does not account for uncertainty. Savage puts forward that even if there is total uncertainty about the outcomes, the decision maker's subjective probabilities can satisfy the rules of probability theory and the decision maker will maximise expected utility with respect to some subjectively held probabilities if certain axioms are satisfied.[668] These axioms will allow to treat uncertainty similar to risk by incorporating subjective probabilities.[669]

To understand a subjective probability, or second-order probability, consider the following example. You have found a coin of unknown origin, i.e., initially there is no information as to whether the coin is biased or not. There is a possibility that the coin once belonged to a cardsharp, so it can be unfair. If the coin is fair, the probability of getting heads or tails is .5, but because the coin belonged to the cardsharp, there is uncertainty as to the fairness of the coin. So, this very uncertainty can be expressed by the subjective probability that the coin has various first-order, i.e., objective probabilities of landing heads or tails.[670] If

[667] J T Casey and J T Scholz, 'Beyond deterrence: behavioural decision theory and tax compliance', (1991) 25 Law & Society Review 821

[668] L J Savage, *The foundations of statistics*, (Wiley, 1954)

[669] P Anand 'The nature of rational choice and the foundations of statistics' (1991) 43 Oxford Economic Papers 199

[670] S O Hansson 'Do we need second-order probabilities?' (2008) 62 Dialectica 525, 528; B Skyrms, 'Higher Order Degrees of Belief', (1980), 109 in: ed. D H Mellor, *Prospects for Pragmatism*, (CUP, 1980); J Baron, 'Second-Order Probabilities and Belief Functions', (1987) 23 Theory and Decision 25, 27

you perform a considerable number of tosses this will eventually bring the computation at a better approximation of objective probabilities.[671]

This thesis will not delve into the axioms of subjective utility theory, but a few points must be made. Subjective utility theory originates in the works of Ramsey and de Finetti, who proposed an idea that an individual's beliefs can be inferred from their betting behaviour. To put it differently, individuals beliefs can be inferred from the extent to which the decision maker is prepared to act on their beliefs.[672] As opposed to the VNM model, in the Savage's model, a decision maker chooses between actions rather than lotteries, so probabilities are defined as preferences over acts, and his decisions depend on the states of nature, and which will happen is unknown to the decision maker.[673] The sure-thing principle states that the preference between acts depend solely on the consequences in states in which the payoffs of the two acts being compared are distinct. This implies that the valuation of the consequences of an act in one event is independent of the payoffs of the same act in the complementary event.[674] For example, an insider facing a decision to commit insider dealing or not understands that there can be at least two states occurring, he is either caught, or not caught. If he commits insider dealing and generates £100,000 and is not caught so the state where the insider is not caught materialises. But if the insider commits insider dealing still £100,000 has been made, and the other state materialises even with a lower probability, and the FCA imposes a sanction which is derisory, say £1,000. Apparently, these two states do not really differ between each other.

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[671] Ibid

[672] Ramsey (n 657), and de Finetti (n 657)

[673] Savage (n 668)

[674] For more detailed discussion on the SEU axioms see, Grant, 'Subjective probability without monotonicity: or how Machina's mom may also be probabilistically sophisticated', (1995) 63 Econometrica 159 and See M J Machina and D Schmeidler 'A more robust definition of subjective probability' (1992) 60 Econometrica 745

5.4 Enforcement and sanctions

Maximisation of social welfare and minimisation of social loss from any given offence is the purpose of enforcement.[675] Harm inflicted upon society by the commission of crime should be countervailed by an appropriate enforcement strategy. This enforcement strategy is constructed around the probability of enforcement[676] and severity of punishment.[677] Both these parameters are set up given the following variables,

(i) types of liability, i.e., strict or/and fault-based, the costs of enforcement,

(ii) the certainty of enforcement, i.e., enforcement can be fixed or uncertain,

(iii) risk attitudes of would-be offenders, e.g., mainly risk neutral or risk averse,

(iv) wealth levels of those offenders,

(v) the severity of punishment.[678]

The determination of total harm in insider dealing is not feasible because the real number of committed and not committed insider dealing cases is undeterminable, hence the actual total loss from insider dealing is unknown.[679] Thus, *a priori*, the probability of enforcement is not fixed, but varied, that is, the actual enforcement of insider dealing regulations is lower than the number of investigated cases, not to mention the number of accomplished cases. It was discussed in the previous chapter.

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[675] A M Polinsky and S Shavell, 'The theory of public enforcement of law' (2007) 405, in ed. A M Polinsky and S Shavell, *Handbook of Law and Economics*, volume 1 (Elsevier, 2007)

[676] The probability of enforcement encapsulates the certainty of punishment

[677] Von Hirsh and others (n 589), Barr and others (n 624); R Paternoster and A R Piquero, 'Reconceptualizing deterrence: an empirical test of personal and vicarious experiences', (1995) 32 Journal of Research in Crime and Delinquency 252, 252-53; A R Piquero and G Pogarsky, 'Beyond Stafford and Warr's Reconceptualization of Deterrence: Personal and Vicarious Experiences, Impulsivity, and Offending Behaviour', (2002) 39 Journal of Research in Crime and Delinquency 153

[678] Polinsky and Shavell (n 675)

[679] Not committed insider dealing means cases of improper disclosure of inside information, or encouraging a third person to commit insider dealing, where insider dealing was not committed J Nash, 'Optimal civil penalties' (1986) Working Paper no 138 Federal Trade Commission, 24

For the FCA it is necessary to ensure that its deterrence-based enforcement strategy is designed in such a way so that would-be insiders will think of potential costs from insider dealing as being greater than potential benefits.[680] In this connection, the potential costs are related to the probability of enforcement and severity of punishment, otherwise inadequate enforcement will bring about underdeterrence. To put it differently, for the FCA the primary challenge to tackle is, given the impossibility of catching every insider, to determine a level of punishment that will maintain deterrence owing to which rational would-be insiders will refrain from committing insider dealing.

5.4.1. Becker's view on criminal behaviour

A public enforcement body in enforcing a law simultaneously carries out two_objectives, the maximisation of social welfare and the minimisation of social loss.[681] In doing so, the enforcer aims to make crime less attractive so that fewer persons will break the law. Therefore, there are three fundamental properties of enforcement, (i) social welfare maximisation, (ii) social loss minimisation, which is tackled by setting an optimal probability of enforcement and sanction, and (iii) reduction of the incidence of any given crime. While the first two properties are inversely the same, the third expectation is conditional on the first two properties in that a would-be offender will learn from the enforcement rates.[682] An enforcement rate for the purposes of this discussion is a rate encapsulating the probability of enforcement and the severity of punishment, so should this rate be low, more likely than not a would-be offender will violate. Then, the more the offenders violate, the more harm is inflicted upon society and the bigger is the social loss.

[680] Becker (n 549)

[681] Polinsky and Shavell (n 675)

[682] R K Sah, 'Social osmosis and patterns of crime' (1991) 99 Journal of Political Economy 1272

Social welfare is defined as the sum of the benefits obtained by individuals who commit the harmful act, less the harm done and enforcement costs.[683] The total loss from crime can be represented as loss equals loss (Damages, Costs, Offender Costs, Occurrence of crime).[684]

As the harmful activity level goes up so does the total amount of harm,

$$H_i = H_i\,(O_i) \tag{1}$$

with

$$H_i = \frac{\partial \mathrm{Hi}}{\partial H\mathrm{Oi}} > 0$$

where, H_i is the harm from the i activity, i.e., insider dealing, and O_i is the activity level. Social welfare can be represented as,[685]

$$\int_{f}^{\infty} (g - h) z(g) dg \tag{2}$$

where, g, is gain, z(g), is density of gains amongst individuals, h, is harm and f, is a fine. The level of activities is measured by the number of offences. In insider dealing cases it is not feasible to ascertain the actual number of all insider dealing instances, but the more offences are committed the more is the social value of the gain to offenders.[686]

$$G = G(O) \tag{3}$$

with

$$G' = \frac{\partial \mathrm{G}}{\partial O} > 0$$

[683] Polinsky and Shavell (n 675) 406; A M Polinsky and S Shavell, 'A Note on Optimal Fines When Wealth Varies Among Individuals' (1991) 81 The American Economic Review 618, 619

[684] Becker (n 549)

[685] Polinsky and Shavell (n 675)

[686] Moreover, if offenders obtain diminishing marginal gains they cause additional marginal harm from additional offences

where, G, is the gain from an offence. The costs to society is the difference between harm, h, and gain, g, so,

$$D\ (O) = H(O) - G(O) \tag{4}$$

The probability of committing an offence by an individual is,[687]

$$O_j = O_j\ (p_j,\ f_j,\ u_j) \tag{5}$$

where, O, is the number of offences during a particular period, p, is the probability of conviction per offence, f, is the punishment per offence, u represents all other influences. An increase in either p_j, or f_j, will cause a decrease in expected utility hence in the number of offences, that is,

$$O_{pj} = \frac{\partial Oi}{\partial pj} < 0 \tag{6}$$

and

$$O_{fj} = \frac{\partial Oi}{\partial fj} < 0$$

For the enforcer to be able to do so, there should be a sufficient amount of resources. Becker puts it in the following equation, C = C(A), which is the same as A = f(m, r, c), where in the brackets are manpower, materials, and capital.[688]

Therefore, the utility from committing an offence is,[689]

$$EU_j = p_j\ U_j\ (Y_j\ \text{-}f_j) + (1\text{-}p)\ U_j\ (Y_j) \tag{7}$$

$$\frac{\partial EU}{\partial pj} = U_j\ (Y_j\ \text{-}f_j) - U_j\ (Y_j) < 0$$

$$\frac{\partial EU}{\partial fj} = p_j\ U_j\ (Y_j\ \text{-}f_j) < 0$$

687 Becker (n 549)

688 Ibid

689 Ibid

Where Y_j is the income from crime, and EU is a VNM utility function. Of course, this equation can be extended to including extra-legal costs, but for the purposes of this discussion the original version is sufficient to show the rational economic model of crime.[690] Therefore, an individual will commit a crime if the expected benefit from commission is greater than the costs of non-commission.[691] As a result, the offenders' choices depend on the deterrence criteria of certainty and severity.[692]

5.4.2. Setting the probability of enforcement and severity of punishment

Building on the assumption that an insider will commit insider dealing when this insider believes the potential illegal gains will outweigh the potential costs, this analysis will mainly focus on civil financial sanctions, but it will also pay attention to the availability of criminal sanctions. Setting the probability of enforcement, *p*, and the severity of punishment, *f*, requires the consideration of at least two factors. First, should enforcement of insider dealing regulations be certain, that is, every insider knows that they will be apprehended and punished then risk averse insiders' penalty should be lower than for risk neutral insiders for the former are easier deterred.[693] Second, when enforcement is not certain, as it is the case, then some insider dealing will be allowed to go unenforced.

Scarce economic resources, the quantification issue together with the other discussed challenges to enforcement do not make it possible for the FCA to act on every potential instance of insider dealing. Thus, an *n*-amount of insider dealing goes either undetected or detected but not enforced, and only *n*-proportion of insider dealing is enforced.[694] Knowing these figures

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690 G R Jackall, *Moral Mazes: The World of Corporate Managers*, (edn, OUP, 1988)

691 C Cherniak, *Minimal rationality*, (Cambridge, MIT Press, 1986); R Paternoster and S Simpson, 'Sanction threats and appeals to morality: Testing a rational choice mode of corporate crime' (1996) 30 Law and Society review 549; M R Gottfredson and T Hirschi, *A General Theory of Crime* (Stanford University Press, 1990)

692 Becker (n 549)

693 Ibid 414

694 See the FCA's Enforcement Guide 2.1, 2.2. A similar situation unfolds on the other side of the Atlantic, where for example the Security Exchange Commission enforce only 8.28 per cent of illegal stock and option on the

for sure is impossible for there is no plausible methodology exists which can compute the number of committed instances of insider dealing, not committed insider dealing, as for example, in cases of improper disclosure. But it is possible to set p and f so that would-be insiders, or at least some of them, refrain from violating at some values of p and f.[695] A low p but with maximal f model will economise on enforcement costs,[696] but maximal f creates several problems. Those being caught bear the risk of not being able to pay off the fine due to the absence of wherewithal, or those being caught hide their illegal gains away so that the FCA cannot observe them.[697] In this connection, the FCA can turn to the criminal regime, but this alternative carries even larger enforcement costs.[698] A monetary sanction should be used whenever possible,[699] and criminal sanctions may be used only in situations where fines are inadequate.[700] To put it differently, the criminal regime should be deployed only after a financial penalty has been set as high as possible. Should the FCA choose to impose a combined penalty, it is advised to impose maximal monetary sanction with lower imprisonment because the latter is costly and even lighter sentences are deterrents.[701]

With regards to the civil regime standing alone the imposition of a maximal financial penalty can encounter the problem that the insider cannot afford to pay this penalty. A criminal sanction cannot be imposed at this stage; therefore it is advised to employ the following reasoning. When enforcement is specific a penalty should be maximal, and under general

commonly believed less liquid options market, see P Augustin, M Brenner, and M G Subrahmanyam, 'Informed Options Trading Prior to Takeover Announcements: Insider Trading', (2014) available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.469.4868&rep=rep1&type=pdf, accessed on 20 April 2023

695 Polinsky and Shavell (n 675)

696 Ibid 414

697 Ibid

698 Polinsky and Shavell (n 670)

699 Becker (n 549) 28

700 Posner (n 262), 1195

701 S Shavell, 'Specific versus general enforcement of law' (1991) 99 The Journal of Political Economy 1088

enforcement a penalty increases with the gravity of insider dealing[702] or with expected gains.[703] As an alternative, an increased *p* will lead to higher enforcement costs, but it is expected that the incidence of insider dealing will decline.[704] However, it is unlikely that the FCA, due to its risk-based approach to financial regulations and Principle 1 - efficiency and economy,[705] or any enforcement system for that matter, will be able to uninterruptedly sustain such pace.[706]

Wealth of insiders should be taken into consideration too. It is suggested that the low-wealth group pays everything they have, all others pay a financial penalty which is less than their wealth.[707] When a financial penalty is less than wealth of the highest-wealth group and when this penalty is increased with the lowered probability of enforcement, those being able to pay higher financial penalties will be deterred to an extent,[708] but those who cannot pay the higher financial penalty will be under-deterred.[709] Yet again the problem with all of that is, insiders can effectively conceal their true wealth, as a consequence, the FCA cannot accurately quantify the amount of illegal gains so imposing and enforcing maximal financial sanctions are difficult.[710] Assuming that the FCA cannot observe the true value of wealth, it is prudent to use the threat of imprisonment to induce wealthy individuals to pay a financial sanction,[711] but it

[702] L Wilde, 'Criminal choice, non-monetary sanctions, and marginal deterrence: a normative analysis' (1992) 12 International Review of Law and Economics 333

[703] Stigler (n 566)

[704] Ibid, 413

[705] The FCA is committed to using resources in the most efficient and economical way. As part of this the Treasury can commission value-for-money reviews of the FCA operations

[706] Becker (n 549)

[707] Polinsky and Shavell (n 675); A M Polinsky and S Shavell 'The optimal use of fines and imprisonment' (1984) 24 Journal of Public Economics 89

[708] N Garoupa, 'Optimal law enforcement and imperfect information when wealth varies among individuals' (1998) 65 Economica 479, 483

[709] S Shavell, *Economic analysis of accident law* (Harvard University Press, 1987)

[710] Garoupa (n 708), 480, 483; K Back, 'Insider Trading in Continuous Time' (1992) 5 Review of Financial Studies 387, 409

[711] Polinsky and Shavell (n 675) 445

can lead to risks of losing in court which can negatively affect a deterrent effect.[712] Therefore, when the true values are unidentifiable for certain, the optimal financial sanction is maximal.[713] However, the imposition of this optimal maximal financial sanction may be very difficult to enforce, and if the FCA cannot enforce the advertised maximal penalties, that is, when the FCA creates a divergence between the advertised severity of penalty and the actual imposed penalty, this discrepancy can cause more persons to commit insider dealing.[714]

This thesis thinks that given the difficulties enforcing the optimal penalty, it is reasonable to incorporate the following expectations. First, the quantified illegal gains can be multiplied by a factor representing the likelihood of (i) escaping punishment and/or (ii) misrepresenting the true benefits.[715] Second, given enforcement of an insider dealing instance is far from certain, ideally, a financial a financial sanction should be set at the maximal level, but it this optimality can be barely achieved for the reasons discussed above.[716] Therefore, a financial sanction should be at least greater than the quantified illegal benefits and rise with the gravity of insider dealing. This expectation is congruent with the overall approach under the penalty-setting framework and the dual-regulatory regime of the FCA. But as it was discussed in Section 4.10.1 and Section 4.10.2, the financial penalty's components of disgorgement and penalty reflecting the seriousness of insider dealing may have been at odds with this expectation. Their inter-relationships will be examined and evaluated in chapter six.

5.5. Concluding remarks

This chapter aimed to answer question two and argued that deterrence is a suitable response for insider dealing. Based on the examination of the FCA's regulatory framework against

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[712] S D Bushway and E G Owens, ‘Framing punishment: incarceration, recommended sentences, and recidivism’ (2013) 56 Journal of Law and Economics 301

[713] Polinsky and Shavell (n 675), 431

[714] Bushway and Owens (n 712)

[715] C S Diver, 'The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies', (1979) 79 Columbia Law Review 1435, 1467

[716] A M Polinsky, 'The optimal use of fines and imprisonment when wealth is unobservable' (2006) 90 Journal of Public Economics 823

insider dealing, it was concluded that the operations of the FCA on the whole are consistent with the assumptions of deterrence theory. The effectiveness of a deterrence-based enforcement strategy is subject to the two criteria, the probability of enforcement and the severity of sanctions. In the UK, the former criterion is relatively low, whereas the latter criterion in the criminal regime is stable regardless of a magnitude of punishment, but the civil regime allows for a possibility that a financial sanction can be lower than the quantified illegal gains thereby contradicting the deterrence's objectives, and therefore undercutting the effectiveness of insider dealing regulations. The civil regime poses several unexplored challenges associated with the severity of punishment, because a financial sanction or public censure are imposed against an insider's valuation of potential benefits, which are also monetary. Administrative and disciplinary sanctions are limited in their scope for only authorised or/and regulated persons can be penalised by them. So, if an insider is not such a person, then these sanctions are of no avail. However, there is no research supporting or negating this argument.

Insiders are risk-averse and rational actors, or at least rational enough to fathom out the intensity of enforcement as well as tell the difference between severe and trivial punishments.[717] Insiders think about the consequences of their actions; hence they compute the probability of enforcement and the severity of sanction when deciding to trade.[718] Insiders update their perceptions of deterrence depending on the FCA approach to enforcement.[719]

Achieving maximal penalties are often impossible. A maximal financial sanction cannot always be paid, a criminal sanction is costly and difficult to secure as all the elements of insider dealing should be proven. Optimally speaking, given that at the initial stages of an investigation the FCA usually does not discriminate between the regimes, that is, the civil regime is as likely to be enforced as the criminal regime, then at this stage a financial sanction can be presumed to be maximal with a possibility of the criminal regime taking over should an insider be unable to pay the penalty. However, this strategy will inevitably run up against several setbacks, such as, potentially, there will be more insiders unable to pay the maximal fine in the hope that their cases will not hold up in court resulting in the criminal regime being overused and undermined

[717] J Gobert and M Punch, *Rethinking Corporate Crime*, (Butterworths 2003) 216

[718] B N Cline and V Posylnaya, 'Illegal insider trading: Commission and SEC detection' (2019) 58 Journal of Corporate Finance 247

[719] Paternoster and Simpson (n 691)

with the decreased value of the civil regime and increased enforcement costs.[720] A punishment should, given that insider dealing is an economic-driven crime, at least be larger than the quantified/ or potential illegal gains from insider dealing, and it is not beyond the pale for the FCA to punish an individual harsher than they deserve to prop up deterrence.[721]

[720] Polinsky and Shavell (n 675)

[721] Murphy (n 618)

CHAPTER SIX

An Evaluation of the Civil Regime

This chapter will aim to answer questions (g) and (h). Under the assumption that a financial sanction ought to be greater than the quantified illegal benefits as concluded in chapter five, this chapter will aim to evaluate the FCA's civil penalty-setting framework against individuals by putting forward a *first-of-its-kind* theoretical two-step metric for inferring a deterrent effect from financial sanctions for the purposes of imposition of a civil penalty. This two-step metric will allow to situate a deterrent effect in the enforced and future civil financial sanctions through measuring the relationships between disgorgement and penalty reflecting the seriousness of insider dealing. Therefore, the two-step metric will include only the enforced civil cases against individuals which contain both the financial penalty's components, and only disgorgement for there is always a possibility to additionally impose a penalty reflecting the seriousness of insider dealing. The two-step metric will be predicated upon the presupposition that it is impossible to precisely quantify illegal benefits in a continuous manner, i.e., a quantification issue, with two emerging problems within the civil regime's penalty-setting framework,

(i) the controversial nature of disgorgement as a financial penalty component, and

(ii) the adjustability of a penalty reflecting the seriousness of insider dealing to multiple factors under DEPP.

Having applied the two-step metric to the selected individuals (n = 30) for a period between 2004 and 2021, it will be shown that in around half of the evaluated cases the imposed civil financial sanction turned out to be lower than the quantified illegal gains from insider dealing. It will therefore be concluded that insider dealing regulations in the UK cannot be deemed to be effective through the lens of deterrence.

Furthermore, this chapter will conduct a statistical examination of the level of illegal benefits from insider dealing to find out whether this impact factor influences the magnitude of a civil financial sanction. Having applied a one-way ANOVA test to the impact factor against the three penalty groups there will be observed no statistically significant relationship between the impact factor standing alone and the magnitude of civil financial sanctions.

6.1. The problem and proposed methodologies

Detection with efficient investigations are expected by the Financial Conduct Authority (the FCA) to influence the behaviour of a rational wealth maximiser.[722] Facing a decision whether to deal in inside information or not, a rational actor would likely to refrain from deviating, if the probability of him being apprehended outweighs the potential benefits from the insider dealing.[723] This expectation is however impaired, inasmuch as scarce resources allow neither the FCA nor the firms it regulates to act on all potential instances of insider dealing.[724] Similarly, a sanction that is not sending out a strong deterrent signal coupled with a low probability of enforcement can prompt *some* would-be insiders to offend.[725] At bottom, a financial penalty when imposed should be greater than the quantified illegal benefits from the insider dealing.[726]

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[722] The FCA reiterates that it will '…[A]im to act quickly and assertively to stop immediate harm and impose sanctions to punish offenders and deter others', FCA, Business Plan 2021-22, 6. The FCA uses the reasonable investor test which means that, the investor is a rational and economically motivated investor with some experience of investing in listed shares, but not an investment professional, *Ian Charles Hannam v FCA*, [2014] UKUT 0233 (TCC) 27 May 2014, para 101

[723] Becker (n 549); A M Polinsky and S. Shavell, 'The Theory of Public Enforcement of Law', (2005) NBER Working Paper Series 11780

[724] The FCA Enforcement Guide 2.2.5, sets out that '[T]he combination of the priority given to certain types of misconduct over others and the FCA's risk-based approach to enforcement means that certain cases will be subject to enforcement and others not, even where they may be similar in nature or impact. The FCA's choice as to the use of the enforcement tool is therefore a question of how the FCA uses its resources effectively and efficiently and how it ensures that it is an effective regulator'

[725] Grasmick and Bryjak (n 583); W J Chambliss, 'Toward a political economy of crime', (1975) 2 Theory and Society 149; M Mendes and M D McDonald 'Brining Severity of punishment back in the deterrent package', (2005) 29 Policy Studies Journal 588

[726] Mark Steward, FCA Executive Director of Enforcement and Market Oversight, in his speech delivered at the City & Financial Global Ltd event in London on 12 February 2020 stressed that, (although, he was referring to firms), '…[A] financial penalty is not intended to punish: no element of retribution is involved. Instead, the decision-maker needs to ensure a price for the contravention is sufficiently higher than any gain or benefit was, is or might be in the future', and 'Even well-respected observers mistake the process as a quantification of harm in terms of money rather than a price for breach that is intended to deter others'. DEPP 6.1.2 sets out that 'The principal purpose of imposing a financial penalty or issuing a public censure is to promote high standards of

As it was already pointed out according to DEPP 6.5.3[G], a financial sanction can be made up of disgorgement and a financial penalty reflecting the seriousness of insider dealing. However, it is not entirely clear what is the nature of disgorgement in this structure? Defined as the deprivation of quantified illegal benefits from insider dealing[727] with the primary purpose of ensuring that no person has benefited from the breach,[728] disgorgement is an intricate penalty in many respects. Benson in relation to disgorgement as a civil remedy pointed out the following '[T]he defendant's gain and the plaintiff's loss are not only equal in value but as one and the same thing viewed from two different sides'.[729] What this conveys is that both gain and loss are quantitatively correlative. For example, if person *A* was to be stripped of £10,000, this person would be entitled to rely on disgorgement or restitution to be given £10,000 back. As opposed to typical cases involving disgorgement or/and restitution, as in a contractual context,[730] in insider dealing cases these variables are not necessarily correlative for there being a good likelihood of quantifying an inaccurate amount of ill-gotten gains. As a result, the deterrent effect of a financial penalty can suffer because the overall penalty can be lower than the actual illegal benefits from the insider dealing. The difference between disgorgement and restitution will be discussed in the next section of this chapter, but as it will be argued, there is no significant divergence between these doctrines in insider dealing regulations.

Lay persons cannot bring claims for insider dealing, and disgorgement in non-criminal insider dealing cases is not disgorged to the claimant, inasmuch as it is not easily quantifiable and linkable with the loss incurred by them, unless it was a face-to-face transaction with identifiable victims. Instead, the quantified amount is disgorged to the FCA. In insider dealing cases, a disgorgement figure refers to two diametrically opposing variables. On the one hand,

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regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour'

727 DEPP 6.5C.1[G]

728 FSA, 'Enforcement financial penalties, Feedback on CPO09/19', 2009, para 2.11

729 P Benson 'Disgorgement for Breach of Contract and Corrective Justice: An analysis in outline', (2004) 317, in J W Neyers, M McInnes and S G A Pitel (ed), *Understanding unjust enrichment*, (Bloomsbury Publishing, 2004)

730 See for example, A C Cares and S H Haynes, 'Restitution, a different kind of economic sanction' (2018) 17 Criminology & Public Policy 815; J Perillo, 'Restitution in a contractual context' (1973) 73 Columbia Law Review 1208

it is a penalty, but on the other hand, it is the amount of quantified illegal benefits. One of the logical ways of evaluating disgorgement as this thesis will contend is to juxtapose it against a monetary penalty.[731]

Both the financial penalty's components are set out to penalise, but the purpose and determination of disgorgement and a penalty reflecting the seriousness of insider dealing differ. Disgorgement plays two key roles. First, it is some amount of ill-gotten gains which doubles up as a financial penalty if and only if it has been quantified by the FCA. The word 'some' is of cardinal importance because it is difficult for the FCA to conclude with certainty that this quantified amount reflects the amount of all the illegal benefits. For example, it might be the case that due to an insider generating and hiding his illegal profits in two or more jurisdictions. In fact, it should not really matter whether this quantified amount is accurate, because it is still going to be almost impossible to trace into other benefits generated by the insider on top of his unlawful gains.[732]

Conversely, the penalty reflecting the seriousness of insider dealing (the PRSID) is a figure determined by the FCA, which amongst many other factors as it was discussed in chapter four and see Appendix C, is affected by 'the level of benefit gained, or loss avoided, or intended to be gained or avoided, by the individual from the insider dealing, either directly or indirectly', (hereinafter the impact factor).[733] What it points to is that this impact factor is identical to the disgorgement figure, that is, this factor bears on the PRSID, but not the other way around. Once disgorgement has been quantified it becomes fixed, in the sense that it cannot be adjusted later for other factors laid down in the penalty-setting framework, whereas the PRSID can be altered.[734] The elasticity of PRSID allows greater leeway for the FCA, since it is unknown with certainty whether a financial penalty is larger or smaller than the illegal gains from insider

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[731] Most of the accomplished civil insider dealing cases have deployed both types of penalties. The FCA's Manual DEPP 6.5C.2[G], A monetary penalty reflecting the seriousness of the market abuse. The computation of this figure depends on the four categories, (i) the impact of the insider dealing, (ii) the nature of the insider dealing, (iii) whether the insider dealing was deliberate, and (iv) whether the insider dealing was reckless

[732] In the sense that the question of whether these newly generated benefits are too remote from the insider dealing against which the financial penalty is to be handed down is largely irrelevant due to the unprovability of the original illegal amount.

[733] DEPP 6.5C.[G](11)(a)

[734] DEPP 6.5C

dealing. But what it really does is delineate between the quantified illegal benefits to the insider and the PRSID, where the former can be lower than the latter. If a financial penalty aims towards being greater than the potential illegal benefits from insider dealing, then a figure representing disgorgement ought to be smaller than a PRSID. All the while, disgorgement is a penalty disregarding this straddling representation.

This chapter will first attempt to evaluate the relationships between disgorgement[735] and the impact factor under the current penalty-setting framework.[736] These relationships will be evaluated through a devised two-step theoretical metric seeking to ascertain whether a financial penalty consisting of both disgorgement and a PRSID can be smaller than the potential illegal benefits from insider dealing. Should this relationship reveal that a PRSID can be smaller than disgorgement, it will contradict the FCA's deterrent approach to tackling market abuse.[737] To put it differently, the idea to be tested is that, if a disgorgement figure represents both a penalty figure and a quantified amount of illegal benefits on which the disgorgement figure is computed, it should not be greater than the PRSID. The principal argument of this chapter is that for the ambiguous nature of disgorgement the PRSID should never be lower than the disgorgement. Otherwise, the deterrent effect of a civil financial sanction is jeopardised.

In order to carry out an evaluation of the civil regime's penalty-setting framework, this thesis will put forward a unique two-step metric for deriving a deterrent effect from civil financial sanctions for the purposes of penalty imposition and determining the effectiveness of insider dealing regulations. Overall, this approach to evaluating is unique in that, to the best knowledge of the author there has been no research using algorithms in situating a deterrent effect in civil financial sanctions against insider dealing. Moreover, this approach is justified for the following two original reasons,

(1) The discussed challenges to enforcement in this thesis will be reduced to the quantification issue in the context of a properly devised deterrence-based enforcement strategy with the ambiguous nature of disgorgement. In particular, it will be stated that the disgorgement figure represents not only the penalty, f_p, but also the amount of illegal benefits, f_b on which it

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735 DEPP 6.5C.1

736 DEPP 6.5C.2(11)(a)

737 FCA, Our strategy 2022 to 2025, available at https://www.fca.org.uk/publication/corporate/our-strategy-2022-25.pdf, 19

is quantified. Disgorgement is conditional on the quantified illegal benefits. If there are no quantified illegal benefits there will be no disgorgement, but the opposite is not true. So, the absence of f_p does not rule the existence of f_b. All of these will be regarded as the underlying assumptions of the two-step metric. A more detail on this will be provided in section 6.3.

(2) The challenge of locating deterrence, as it was discussed in chapter five, will be circumvented by virtue of the two-step metric as the assumptions of deterrence theory will be incorporated so that a deterrent effect can be inferred from the observed enforced civil cases in the same way as it would be observed and perceived by the public.[738] The two-step metric will therefore evaluate the deterrent effect not from the mere enforcement rates, but through the potential deterrent effects originating in the imposed civil financial sanctions.

Since financial sanctions are pecuniary, this thesis will argue that the best way to evaluate them with a view to inferring a deterrent effect is to devise and apply economic models.

The two-step metric will begin with grouping of the civil insider dealing cases against 30 individuals[739] in accordance with the following categories,

(1) A financial penalty is greater than the quantified illegal benefits,

(2) A financial penalty is smaller than the quantified illegal benefits,

(3) A positive financial penalty break-even point.

In order to arrive at one of these categories, each case where both disgorgement and PRSIDs have been imposed will be evaluated by its total financial penalty subtracted by f_p. Where the resulting figure is an additional monetary penalty, α. Now, as it would be in the case where only a PRSID is imposed, this operation separates these two financial penalty components by $\alpha - f_p$, which produces their difference, ω, to be compared against f_b. Another way of looking at it is since $f_p = f_b$, it is not double counted, but it is twice referred to, therefore, f_p should be eliminated for grouping is a measure for the disgorgement figure which is identical and should not be counted twice.

So, these categories can be expanded as,

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738 Gibbs (n 548), Lessig (n 612), Bandura (n 613), Lichtenstein and others (n 614), Geis and Szockyj (n 658)

739 In which both disgorgement as a penalty and a monetary penalty were deployed; or where both financial penalties could have been deployed

$$\alpha - f_p > f_b, \text{ is } \omega > f_b$$

$$\alpha - f_p < f_b, \text{ is } \omega < f_b$$

$$\alpha - f_p = f_b, \text{ is } \omega = f_b$$

In the second step of the model, a deterrent rate will be devised, ς. It is applied to both $\omega > f_b$ and $\omega < f_b$ and obtained by $\varsigma = \frac{\alpha}{\alpha - fb}$ to define the difference between these two groups for α. I found that for $\omega > f_b$ ($n = 13$), ς is locked within the value of 1, and for $\omega < f_b$ ($n = 11$), ς is everywhere above the value of 1 or below the value of 0. The other six individuals will fall under the third category, a break-even point to be explained later in the chapter.

The deterrent rate corroborates the grouping step in that when the difference between the additional monetary penalty and the disgorgement figure is small therefore bigger ς, but when the difference is large therefore smaller ς. This deterrent rate propounds a methodology for solving for a PRSID by measuring its severity of penalty. The obtained results show that where the deterrent rate is greater than 1 and below 0, the PRSID is lower than the quantified illegal benefits, whereas when the deterrent rate is within the value of 1, the PRSID is greater than the quantified illegal benefits.

6.2. Defining disgorgement

Like restitution, disgorgement aims to make wrongdoing unprofitable,[740] both doctrines are non-compensatory in nature,[741] and they are limited by their own quantifications, meaning that respondents are not to be disgorged more than the quantified amount.[742]

[740] T C Mira, 'The Measure of Disgorgement in SEC Enforcement actions against insider traders under rule 10b-5', (1985) 34 Catholic University Law Review 445. *Attorney-General v Guardian Newspapers Lt*d (No 2) [1990] I AC 149, 286 (Lord Goff), *Attorney-General v Blake* [2001] I AC 268, 278 (Lord Nicholls); as a component of restitution in *ABK Ltd v Foxwell* [2002] EWHC 9

[741] R B Grantham and C E F Rickett, 'Disgorgement for unjust enrichment?' (2003) 62 Cambridge Law Journal 159

[742] P B H Birks, *An introduction to the law of restitution* (Oxford, Clarendon Press, revised edn, 1989), 352

Pinning down a precise difference between these doctrines, especially in insider dealing regulations is not that simple. Restitution is about 'giving back' the illegal gains,[743] that is, '…[To] reverse the transfer of value from the claimant to the defendant'.[744] A good example is the case of *Patel v Mirza*.[745] In brief, Patel had transferred £620,000 Mirza to invest into Royal Bank of Scotland shares based on inside information which the latter was about to lay hold of. However, this inside information was never meant to materialise, so no insider dealing was committed. Despite that, Mirza refused to pass the given money back to Patel. The Supreme Court upheld the decision of the Court of Appeal in awarding Patel restitution in the amount of £620,000 thereby bringing the parties back to their initial position before the transfer of the money took place.

Disgorgement is said to be about 'giving up' the illegal gains,[746] which operates irrespective of whether '[T]hat gain was not obtained from the claimant',[747] which can therefore also be disgorged to the State.[748] For the FCA it is Step 1 in the penalty-setting framework defined as '[t]he FCA will seek to deprive an individual of the financial benefit derived as a direct result of the market abuse (which may include the profit made or loss avoided) where it is practicable to quantify this…'.[749] Furthermore, pursuant to sections 382, 383 and 384 of the FSMA 2000, the FCA can apply to the court for restitution, albeit the procedure and prerequisites to be fulfilled are strictly demarcated.[750]

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743 *K Barker, 'Riddles, Remedies and Restitution: Quantifying Gain in Unjust Enrichment Law' (2001)* 54 *Current Legal Problems 255, 258*

744 G Virgo, 'Restitutionary Remedies for Wrongs: Causation and Remoteness' in Charles E F Rickett (ed), Justifying Private Law Remedies (Hart 2008), 302

745 [2015] UKSC 23

746 Barker (n 549) 258

747 Virgo (n 744), 302, see also L Smith, 'Restatement of the law Third: Restitution and Unjust Enrichment' (2013) 57 McGill L. J 629

748 A R Mitchell, SME Taylor & KV Talbot, *Confiscation and the Proceeds of Crime*, (2nd eds Sweet and Maxwell, 1997)

749 DEPP 6.5C.1[G]

750 Enforcement Guide 11.1 points out that the FCA will use this power very rarely, if and only if there are no other ways for the person to obtain redress

Disgorgement and the FCA's powers to seek restitution coincide in that restitution can be equivalent to disgorgement. That was the case for Gavin Breeze, who had avoided a loss of £1,900, was ordered by the FCA to pay restitution in the amount of £1,850 with interest amounting to £259, which was to be passed by the FCA to the victims.[751] Had there been no victims, this £1,900 would have been disgorged to the FCA with the purpose of maintaining deterrence[752] and preserving the integrity of the financial markets. But because the victims were able to show the causal link between their losses and the insider's wrongdoing, restitution was awarded which effectively cancelled out disgorgement. It signified that both sanctions can be interchangeable and mutually exclusive.[753]

Current academic literature is silent on what does disgorgement do to the financial penalty in insider dealing regulations. If it is alike to restitution brings a wrongdoer to the position had there been no insider dealing, it makes it difficult to evaluate. Such an evaluation cannot be performed on disgorgement in isolation. First, given that the loss and the gain in cases involving two or more parties are correlative,[754] in insider dealing cases this correlation is contestably the face value, inasmuch as an insider is normally set out to 'beat the market', and not particular market participants. Meaning that the actual illegal benefits generated from the insider dealing are not as easily quantified as in cases with face-to-face transactions between persons where the casual link is usually established linearly. Second, if the penalty and the illegal gains are represented by the same figure then it does not provide sufficient data

[751] FCA, Final Notice against Gavin Breeze, 15 July 2016

[752] Enforcement Guide 2.2.4 on case selection and referral criteria cases will be enforced where the FCA thinks are necessary to achieve effective deterrence. Furthermore, in 2.2.9, in non-criminal market abuse greater emphasis will be given to the egregiousness and deterrence value of a particular case. This principle of deterrence was also singled out by Mark Steward, FCA Executive Director of Enforcement and Market Oversight in his speech delivered at the City & Financial Global Ltd event, London on 12 February 2020. Which is in line with DEPP 6.1.2[G] The principal purpose of imposing a financial penalty or issuing a public censure is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour. Financial penalties and public censures are therefore tools that the FCA may employ to help it to achieve its statutory objectives. Amongst other things early detection, to repair harm that has occurred, especially financial loss to consumers

[753] There was another case of Steven Harrison 8 September 2008, who was penalised £52,500 for making a profit by encouraging € 44,000

[754] Benson (n 729)

as to whether the penalty is small or large since it just restores the 'original' state, which might be done inaccurately. Therefore, either a qualitative or quantitative evaluation of disgorgement standing alone would be a waste of time because the question whether a disgorgement figure is small or large is a baseless question unless it is attached to the notion of the other financial penalty component, which is the penalty reflecting the seriousness of insider dealing (the PRSID).[755] By juxtaposing the disgorgement against the PRSID should shed light on the severity of the total financial penalty.

6.3. Assumptions underpinning the two-step metric

Either in combination with each other or independently, both disgorgement and a PRSID make up a financial penalty. But they differ in their underlying structures, and what is more important computational methodologies.[756] The divergence between the definition of disgorgement and its purpose in large measure manifests itself in the impossibility of being certain that a quantified amount of illegal gains is indeed the accurate representation of the illegal gains.[757]

On the other hand, a PRSID is a bespoke penalty, that is, to be determined by the FCA depending on the various pre-set factors as set out in 6.5C.2[G] of the Decision Procedure and Penalties Manual (DEPP).[758] No single factor has a bearing on disgorgement. That said, once a disgorgement figure has been quantified by the FCA, it cannot be adjusted for any considerations of the FCA's five-step penalty-setting framework.[759] But a PRSID can be

755 DEPP 6.5C.2[G], A monetary penalty reflecting the seriousness of the market abuse. The computation of this figure depends on the four categories, (i) the impact of the insider dealing, (ii) the nature of the insider dealing, (iii) whether the insider dealing was deliberate, and (iv) whether the insider dealing was reckless

756 DEPP 6.5.3[G]

757 G Dissanaike and Kim-Hwa Lim, 'Detecting and quantifying insider trading and stock manipulation in Asian markets' (2015) 14 Asian Economic Papers 1

758 This Manual is to satisfy the requirements of FSMA 2000, see DEPP 1.1.2

759 DEPP 6.5C.3[G](1), DEPP 6.5C.5[G]

adjusted, and even be omitted when it is to be imposed together with disgorgement indicating that it is disgorgement which holds sway in this relationship.[760]

Dominance of disgorgement over a PRSID is not fitting for the penalty-setting regime's deterrence objective. Disgorgement simultaneously constitutes several dimensions. As a penalty disgorgement represents the quantified amount of illegal benefits which are transformed into a penalty. Stemming from the assumption that it is impossible to be certain as to the accuracy of the disgorgement penalty figure, this characteristic of disgorgement can be extended to propounding that the absence of illegal benefits does not rule out the possibility of such illegal benefits existing. Which is the same as surmising that an amount of quantified illegal benefits, likewise, does not preclude the existence of other unidentified illegal benefits. The purpose of disgorgement as a penalty is premised on the assumption which is unrealistic since its very scope is locked in its own quantification. Therefore, it is not prudent to rely on the quantified figure in determining the magnitude of a financial penalty.

The first property of disgorgement ties in the second property which I call 'constancy' or a 'fixed' property. As it was already touched upon, disgorgement once quantified cannot be adjusted for any factors or considerations laid down by the five-step framework, so it is somewhat 'fixed' in relation to its quantified figure.[761] The problem here is that a PRSID is adjustable. The PRSID can be raised or lowered depending on the facts of any given case in accordance with the five-step framework. The point here is that when a PRSID increases against a 'fixed' disgorgement figure, the difference between these two financial penalty components widens. On the contrary, when a PRSID is reduced, the difference between the financial penalty components narrows. Thus, it shows the severity of a PRSID at different levels with respect to disgorgement. Manipulation of a PRSID is a handy tool in the hands of the FCA making up for the probability of incorrectly quantifying the true disgorgement figure. To that end, it seems that it should spark no concern since the difference between the financial penalty components is the difference between the penalties designed to punish. A PRSID

[760] The FSA in its several Final Notices issued after the introduction of the five-step framework referred to a monetary penalty as an additional penalty. FSA, Final Notice against Mehmet Sepil, PN/028/ 12 February 2010; FSA, Final Notice against Murat Ozgul, 12 February 2010, PN/028; FSA, Final Notice against Levent Akca, 12 February 2010, PN/028

[761] Of course there is nothing preventing the FCA from changing this figure so long as it can prove that the insider generated this 'updated' amount of benefit

should be allowed to be adjusted reflecting the seriousness of the insider dealing, but! when it slides down to disgorgement, assuming that it is initially greater than disgorgement, then it creates a problem.

Unpicking it necessitates looking at one of the factors impacting the magnitude of a PRSID.[762] This factor is,

> '[T]he level of benefit gained, or loss avoided, or intended to be gained or avoided, by the individual from the market abuse, either directly or indirectly.'[763]

This impact factor evinces a figure straddling two states, a penalty, i.e., disgorgement on the quantified illegal benefits, and illegal benefits standing alone as if in a world where they have not been quantified. Yet, both states are attached to the same monetary figure, disgorgement is conditional on the quantification of illegal benefits, which are potentially inaccurately quantified. Then again, if there was no illegal benefit quantified, there could not be disgorgement, but the opposite is not true, that is, the absence of disgorgement does not eliminate the potential existence of the illegal benefits. For this reason, given that disgorgement ought not to be greater than the illegal benefits it is thereby less than or equal to the illegal benefits. All in all, this inequality questions not only the accuracy of disgorgement as a penalty, but it explicitly undermines its role in setting the appropriate and proportionate financial penalty. Because if disgorgement is at least on the face value correlative with the quantified amount of illegal benefits from insider dealing, then the latter can be greater than a PRSID and therefore the total financial penalty.

The existing penalty-setting regime does not recognise such differentiation; hence, it does not recognise a reality where a financial penalty can be smaller than the illegal benefits. If it is how the land lies, then a disgorgement figure is at variance with the very idea of deterrence. Which simply states, a benefit from a violation should not be greater than a penalty.[764] This is not to conclude that a penalty should be many times the amount of illegal

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[762] DEPP 6.5C.2 step 2, the seriousness of the market abuse

[763] DEPP 6.5C.2[G](11)(a)

[764] It is widely accepted that a rational individual is expected to refrain from committing an offence if the risk associated with the offence outweighs the rewards, Becker (n 544)

benefits, but it at least ought to be reasonably higher and increased with the gravity of insider dealing.[765]

6.3.1. Impossibility of ascertaining actual illegal benefits

It is clear from the definition of disgorgement, that it does not aim to be exhaustive or precisely accurate, rather it is what is practically quantifiable.[766]In line with this, the proposed two-step metric is based upon the assumption that it is not possible to ascertain the precise amount of ill-gotten gains to begin with. Suggesting that any figure quantified for the purpose of disgorgement can be greater, lower or equal to the actual illegal benefits. Of course, it is the FCA's task to quantify this amount because it is unlikely that an insider will come forward letting out his actual benefits.

Typically, according to the completed civil cases of insider dealing, a civil case can be looked at through two general parameters, whether an insider is a first-time offender, and whether his misconduct was a one-off event. All the civilly penalised insiders considered in this study were deemed to have been first-time offenders. No Final Notice against them mentions any instance of recidivism.[767] The other parameter will be elaborated on the discussion carried out in section 4.9, and it requires a deeper critical understanding. In this thesis, a one-off event will be defined as any event which is not frequent. Frequency in its turn is the number of transactions consummated, orders opened or closed or instances of improper disclosure of inside information and so forth.[768] Establishing the actual frequency of insider dealing is complicated, to say nothing of the duration. For example, in high frequency trading this number can be so staggering that any computation of it will likely be approximate. Frequency shades into legitimate and illegitimate trades. In this connection, an illegitimate trade is insider dealing, so its frequency should be affixed to a piece of inside information. So

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765 Stigler (n 566)

766 DEPP 6.5C.1[G], 'The FCA will seek to deprive an individual of the financial benefit derived as a result of the market abuse (which may include the profit made or loss avoided) where it is practicable to quantify this'

767 A final notice sets out the terms of the action that the FCA is taking as set out in s. 360 FSMA 2000

768 DEPP 6.5C.2[G](12)(a) and (13)(g), one of the factors reflecting the seriousness of the insider dealing, that it was deliberate, and his actions were repeated, and the frequency of the market abuse

that if an insider possesses a single piece of inside information and splits it up to conceal the illegal trades, the frequency of his trades is nonetheless constrained by a finite amount of time within which this inside information has value. Contrastingly, if the insider possesses several unrelated pieces of inside information, then the frequency parameter becomes continuous in the sense that these pieces of inside information are separating from the (one-off) insider dealing against which a financial penalty is to be imposed. Consequently, disgorgement is circumscribed by the facts of a particular case, or cases which the FCA is practically able to quantify its frequency. Thus, a disgorgement figure cannot contain an amount which is not quantified, but it does not invalidate the possibility of such other illegal benefits existing.

Another way of looking at it is by looking at the average number of months needed for the FCA to accomplish a civil case of insider dealing, this average is 31months. This was calculated by taking the date when insider dealing was committed until the FCA issued a final notice. Now, say that the amount quantified for the purposes of disgorgement is exactly £20,000. But it is still impossible to prove, or at least barely possible whether within these 31 months, the insider had not doubled, tripled and so forth these illegal profits. The issue here is that such ensuing profits may be too remote to be attached to the insider dealing.[769] A good analogy in this regard is that a disgorgement figure is the same as a bank loan taken out at interest by the insider with a very low probability of paying it back. The creditors and victims here are uninformed investors.

6.3.2. Adjustability of monetary penalty under Step 2 DEPP

Disgorgement is not adjustable for any subsequent considerations.[770] So if it is set at £25,000 it cannot be raised to £30,000 without firstly proving that £30,000 was generated. Even if the

[769] In *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, para 97 Lawrence Collins J recognised that there must be 'some reasonable connection' between the wrong and the benefit which was obtained as a result of it. At the same time in the criminal case of insider dealing FCA, 'Insider dealer Walid Choucair ordered to pay 3.9 million in confiscation', 2021, Press Release, available at https://www.fca.org.uk/news/press-releases/insider-dealer-walid-choucair-ordered-pay-3.9million-confiscation, the Court was permitted to assume that some other profits arising from other trading carried out by the insider were also proceeds of crime

[770] DEPP 6.5C.3[G](1) 'The FCA may increase or decrease the amount of the financial penalty arrived at after step 2, but not including any amount to be disgorged as set out in step 1, to consider factors which aggravate or

insider had made a profit of £30,000 or more. Similarly, it cannot be slashed down to say £20,000. A PRSID if set at £25,000 can be raised or chopped depending on two sets of considerations. First, a PRSID is determined based on the factors reflecting the seriousness of the insider dealing under DEPP 6.5C.2[G]. Second, this determined figure can be further adjusted for steps 3, 4 and 5 of the penalty-setting regime.

Adjustments concerning settlement discounts at step 5, or in general financial penalty discounts on the other hand can illustrate how a PRSID can change before and after the application of a discount. From 2004 until 2021, the Regulator has awarded around £805,834 in different types of financial penalty discounts.[771] This total amount may appear trivial, but if measuring it against penalty groups it can provide a critical insight into the problem. To show that the enforced civil cases against individuals are divided up into three penalty groups, up to £40,000, between £40,000 and £100,000 and above £100,000. Each group is composed of two categories, '[t]otal amount of penalties would have been amounted to (including financial discounts)', represents an amount of financial penalties which would have been imposed on the wrongdoers had there been no financial discounts. The other category is '[t]otal amount of penalties excluding financial discounts', which is the actual amount of penalties imposed on the insiders.

Table 4. Penalty Group Below £40,000

Total amount of penalties would have been amounted to	Total amount of penalties excluding financial discounts
£539,904	£293,370
Average penalty including financial discounts	Average penalty excluding financial discounts
£35,997 what would have been	£19,558 based on the existing system

mitigate the market abuse. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2'

[771] It includes DEPP 6.5D of the Manual, serious financial hardship

There have been 15 individuals penalised by a penalty below £40,000, which is about 35 per cent of all the civil cases. The total amount of awarded financial discounts is £246,534, which on average is £16,435 per case, as against the average for the total penalty of £19,558. The difference between these averages is inconsequential £3,123 given that the penalty group ceiling is capped at £40,000.

Table 5. Penalty Group between £40,000 and £100,000

Total amount of penalties would have been amounted to	Total amount of penalties excluding financial discounts
£697,642	£624,142
Average penalty including financial discounts	Average penalty excluding financial discounts
£69,642	£62,142

There have been 10 individuals penalised by a penalty between £40,000 and £100,000. The total amount of financial discounts is £132,500 as against £624,142 in penalties. The average discount here is £13,250 which is just about one fifth of the average penalty of £62,142.

The final group is above £100,000 which also consists of 10 individuals.

Table 6. Penalty Group above £100,000[772]

Total amount of penalties would have been amounted to	Total amount of penalties excluding financial discounts
£4,472,951	£4,046,151
Average penalty including financial discounts	Average penalty excluding financial discounts
£447,295	£404,615

[772] We deliberately decided not to include the case of David Einhorn. Had we included this case it would have skewed the results significantly in this group. In this case the total penalty was £3,638,000, with no financial discounts. But he generated a profit of £660,795 and avoided loss of £5,800,000 which is in total £6,546,795. If you take these quantified benefits, you receive negative £2,822,705 of the pure penalty. So, if this outlier case would have been included then the covariance would have been negative

The total amount of financial penalty discounts is £426,800. The average penalty is therefore £404,615. The average discount is £42,680, and the difference between the averages is £384,120.

Financial penalty discounts demonstrate how a PRSID depreciates against disgorgement. Mention should be given to step 4, adjustment for deterrence. DEPP 6.5C.4[G](1)(a) sets out that if the FCA considers the absolute value of the penalty too small in relation to the market abuse to meet its objective of credible deterrence a monetary penalty can be ratcheted up. This absolute value can refer to both disgorgement and PRSID. In terms of disgorgement, the quantification issue says that this figure can be inaccurate pertaining to the actual amount of illegal gains. Therefore, this absolute value can be increased if the FCA is able to prove this amount of illegal benefits, with a PRSID sliding up, down or remaining intact. If it moves up then assuming that disgorgement is fixed, the difference between the penalties increases and the total value of a financial penalties is amplified too. If a PRSID strides down, then it walks closer to the disgorgement figure, again assuming that this figure remains unaltered. The closer the PRSID figure marches towards the disgorgement figure the narrower becomes the difference potentially leading to a situation where a monetary penalty slips below disgorgement.[773]

6.4. The two-step metric

The total of 30 of individuals met the inclusion criteria. The criteria are straightforward, only those enforced civil cases will be included which contain both disgorgement and PRSID, or disgorgement alone, as shown in Table 7 below. Total Penalty is divided into the two adjacent columns, where f_p stands for a disgorgement figure and α represents the PRSID. In the last column, $\alpha - f_p$, it is shown that when the PRSID is subtracted from the disgorgement the obtained figure reflects the difference between these two financial penalty components which

[773] That was the case in *David Massey v. Financial Services Authority* [2011] Upper Tribunal (Tax and Chancery Chamber) UKUT 49 (TCC) 2 February 2011. The Upper Tribunal brought down the initially proposed financially penalty by the FSA from £281,474 to £150,000, in the region of the amount of profit made which was £111,474.

will be used in comparing against the quantified illegal benefits, f_b. The proposed metrics will not be adjusted for the quantification issue for the following reasons,

(1) since there has been no similar research, it is reasonable to begin an evaluation by defining the basic relationships,

(2) adjustment for the quantification issue is more needed for the FCA to impose a proportionately deterrent penalty, but it is irrelevant for would-be insiders observing the severity criterion through the Final Notices, press releases and so on.

Table 7. The Cases with Disgorgement

Source: The FSA and FCA Final Notices

Case name	**Total Penalty**	$\mathbf{f_p}$	$\boldsymbol{\alpha}$	$\boldsymbol{\alpha}$ **-** $\mathbf{f_p}$
Robert Middlemiss	£15,000	£6,825	£8,175	£1,350
Peter Bracken	£15,000	£2,824	£12,176	£9,352
Michael Thomas Davies	£1,000	£420	£580	£160
Robin Mark Hutchings	£18,000	£4,924	£13,076	£8,152
Arif Mohammed	£10,000	£3,750	£6,250	£2,500
Jonathan Malins	£25,000	£6,400	£18,600	£12,200
James Boyd Parker	£250,000	£121,742	£128,258	£6,516
Richard Ralph	£117,691	£12,691	£105,000	£92,309
John Shevlin	£85,000	£38,000	£47,000	£9,000
Mehmet Sepil	£967,005	£267,005	£700,000	£432,995
Steven Harrison	€52,500	€44,000	£4,500	≈-£40,000*
Levent Akca	£94,062	£10,062	£84,000	£73,938
Filip Boyen	£81,982	£29,482	£52,500	£23,018
Darwin L. Clifton	£275,541	£85,541	£190,000	£104,460
Byron Holdings				
Erik Boyen	£176,254	£127,254	£49,000	-£78,254

* Because of the foreign currency exchange conversion this amount is approximate

Jeffery Burley	£157,500	£21,700	£135,800	£114,000
Jeremy Burley				
Andre Jean Scerri	£66,000	£46,000	£20,000	-£26,000
Mark Samuel Taylor	£36,285	£3,498	£32,787	£29,289
Murat Ozgul	£105,240	£35,240	£70,000	£38,256
David Massey	£150,000	£111,474	£38,256	-£72,948
David Einhorn	£3,638,000	£660,795	-£2,822,795	-£9,283,590
		£5,800,000		
Kenneth G. Carver	£35,212	£24,207	£11,005	-£13,202
Philip Jabre	£1,500,000	£500,000	£1,000,000	£0
GLG Partners LP				
Bettie C. Hatcher	£56,098	£56,098	£0	£0
Stewart McKegg	£14,411	£14,411	£0	£0
Brian V. Taylor**	£4,462	£4,462	£0	£0
Robbin Chhabra	£285,541	£85,541	£200,000	£145,459
Sameer Patel				
Gavin Breeze	£61,686	£2,109	£59,557	£57,448

6.4.1. Grouping of cases

The first step to evaluating disgorgement is to allocate each case based upon the difference between $\alpha - f_p$, which is denoted as ω, and compared against f_b. So, each of these individuals will be computed by,

Total Penalty = $f_p + \alpha$, where

$\alpha - f_p = \omega$, is the difference between the penalties,

which is either $\omega > f_b$ or $\omega < f_b$ or $\omega = f_b$

The three groups are,

** The penalty was composed solely of disgorgement

(1) $\omega > f_b$, that is Total Penalty $> f_b$ and therefore positive, in the sense that a financial penalty is greater than the illegal benefits

(2) $\omega < f_b$, Total Penalty $< f_b$ and therefore negative

(3) $\omega = f_b$ that is Total Penalty $= f_b$ is a break-even point.

Again, ω is the difference between $\alpha - f_p$. Logically, when $f_p = f_b$, it is twice referred to, therefore it is necessary to eliminate f_p and obtain the difference to be compared against f_b which will tell the severity of a financial penalty pertaining to the quantified illegal benefits. Another justification behind $\alpha - f_p$ is that both f_p and α are the components of a financial penalty, that is, each can be deployed separately. For instance, say the total penalty is £13,000, where f_p is £3,000, then α equals £10,000. Both financial penalty components are active in this example. If f_p is not quantified, then this total penalty of £10,000 is equivalent to α. On the other hand, if the only penalty is f_p, there is no α, then $f_p = f_b$. Thus, $\alpha - f_p$ effectively bisects these penalty components from each other, where f_p branches out into $f_p = f_b$.

In the bottom of Table 4, there are some cases where $\alpha = 0$. Simply put, it means that disgorgement was the only penalty imposed. The reason for including these cases was that the Regulator could have imposed a PRSID on top of the disgorgement figures but decided not to do so. This of course differs to the cases where disgorgement was not quantified, leaving the Regulator with no other choice but to impose a PRSID penalty as the only financial penalty.

As regards the cases where ω equals negative numbers, this abnormality is caused on the score of several reasons. Consider, if α = £100,000 and f_p = £25,000, then patently $\alpha > f_p$, and $\omega > f_b$. By increasing f_p to say £50,000, it will still be $\alpha > f_p$, but $\omega = f_b$. This situation I call a break-even point. Because if keeping α constant at £100,000 but with f_p moving up from this break-even point to £50,001, where there is still $\alpha > f_p$, but it is nonetheless $\omega < f_b$, although by a very negligent margin of £1. In other words, when the difference between α and f_p narrows it leads to $\omega < f_b$. For this reason, it is sensible to keep disgorgement fixed and a monetary penalty adjustable, but latter can be adjusted in either direction in relation to disgorgement which is fixed relative to its quantification. So only if this quantification changes so does disgorgement. Therefore, with an increasing monetary penalty but with decreasing disgorgement will inevitably bring about $f_p = 0$, or being unquantified.[774] That is why, when f_p is fixed at some quantified figure, α should not sink below the positive break-even point, but only climb up. By

[774] For example, α £13,000 and f_p £7,000, then $\alpha < f_p$. If keep carrying on with this, α becomes £14,000 and f_p =£6,000, then $\alpha < f_p$. But if keep adding to α and subtracting from f_p will lead to $f_p = 0$

way of an example, if α = £21,000 and f_p = £10,000…, α = £30,000 and f_p = £10,000 and so forth,[775] obtaining a positive difference between ω and f_p. But if α is reduced with constant f_p, the difference will eventually become negative. As if α = £19,000 and f_p = £10,000, … α = £13,000 and f_p = £10,000, …, leading to a negative point when say α = £9,999 and f_p = £10,000, although in this example by a minimal margin of -£1. So, if $\alpha < f_p$, as in α = £9,000 and f_p = £11,000, the resulting figure will be negative, i.e., -£2,000. This negative border will eventually lead to $\alpha = 0$ as opposed to $f_p = 0$.

6.4.2. Checking for groups

By applying the first measurement it was found that 11 cases fall under $\omega > f_b$, 13 cases belong to $\omega < f_b$, and $\omega = f_b$ was computed in five cases.[776] These findings are significant in that they show that in 13 cases the financial penalties were smaller than the quantified illegal benefits. Now, in order to back up the existence of $\omega > f_b$ and $\omega < f_b$, I developed a deterrent rate, ς, which takes the differences between these two groups but now solves for α. It is carried out on the strength of the argument in which if the difference between α and f_p becomes narrower, then $\omega < f_b$, and vice versa. The deterrent rate is obtained by $\varsigma = \frac{\alpha}{\alpha - fp}$. The results are shown in Table 8 below,

[775] Certainly, in increasing a PRSID common sense and marginal deterrence should not be ignored when imposing a hefty financial penalty on an individual in financial hardship

[776] In three cases only the disgorgement element was deployed, in other two cases there was a break-even point

Table 8. Deterrent rate for $\omega > f_b$ and $\omega < f_b$

$\omega > f_b$	$\omega < f_b$
$\varsigma = 1.3$; $\varsigma = 1.6$; $\varsigma = 1.52$; $\varsigma = 1.13$; $\varsigma = 1.61$; $\varsigma = 1.13$; $\varsigma = 1.81$; $\varsigma = 1.19$; $\varsigma = 1.11$; $\varsigma = 1.74$; $\varsigma = 1.00$[777]	$\varsigma = 6$; $\varsigma = 3.62$; $\varsigma = 2.5$; $\varsigma = 19.68$; $\varsigma = 5.22$; $\varsigma = 2.28$; $\varsigma = 2.01$; $\varsigma = -0.63$; $\varsigma = -0.11$; $\varsigma = -0.77$; $\varsigma = -0.52$; $\varsigma = -0.83$; $\varsigma = -0.87$

These two groups require different interpretations. The first group $\omega < f_b$ indicates that the actual difference between α and f_b is small therefore bigger ς. In the former case it is the opposite, the difference between α and f_b is large therefore smaller ς. It also shows that after grouping the cases there is a tendency that for a financial penalty be greater than potential benefits ς is within the value of 1. For the other group where the potential benefits were greater than the financial penalties ς was everywhere even in the domain of negative numbers but not within 1. In relation to the break-even category with six individuals the deterrent rate is 0.

6.4.3. Limitations of the metric

Although, the proposed two-step metric can show the potential deterrent effect of a financial penalty, it is limited to certain conditions. First, the metric is specifically designed for the existing penalty-setting framework model, where both disgorgement and penalty reflecting the seriousness of insider dealing are imposed. This metric can work with cases without a penalty reflecting the seriousness of insider dealing, but it will require further adjustments to cover for the cases without disgorgement. Since the algorithms use disgorgement as a basis for inferring a deterrent effect, should there be no disgorgement quantified, then other factors under DEPP

[777] In the case of Gavin Breeze it should be pointed out that as the FCA puts it in para 4.22 of the Final Notice that if he had sold his entire shareholding at the price he disposed of his shares to the purchasers, he could have avoided a loss of up to 242,000. I did not rely on this hypothetical figure for two reasons. First, the FCA acknowledged that it would have been unlikely for him to sell the shareholding at this price. Second, if this had been included into the measurement it would have brought the deterrent rate down into the dimension of undeterrable penalties, which would be remiss of me to do

should be factored in. A caveat to enter here is that although the two-step metric can be expanded, any other factor to be considered as an addition to or a substitution of disgorgement should be numeric. Second, similarly, other sanctions can be included in the metric, but yet again any inferences being made about a deterrent effect would come up against the problem of statistically or mathematically measuring the cause-and-effect relationships. For example, if this metric to take in say a prohibition order under section 56 FSMA 2000, then this sanction should somehow be converted into a quantitative value. Of course, both added sanctions and factors can be represented by categorical variables to reveal relationships, but they, standing alone will not be able to account for deterrence. Third, basing the two-step metric on disgorgement to some extent can be not entirely reliable due to the quantification issue. Therefore, it is important to stick to the expectation of a deterrence-based enforcement strategy according to which any penalty reflecting the seriousness of insider dealing should be greater than the disgorgement figure. Fourth, the Final Notices are the only reliable source of data, but the FCA can for whatever reason omit potentially statistically significant information from the wording thereby diminishing the accuracy of the two-step metric. Fifth, we can think of only one mathematical issue with ς, it is its averaging. If ς is a negative number, when adding up it takes away from the average, since a positive number is added to the negative one. To get round this problem one may simply turn to <u>two</u> alternative computations. The first one is to take absolute value of the deterrent rate or is to swap round and flipping over $\varsigma = \frac{\alpha}{\alpha - fp}$ to have $\frac{fp - \alpha}{\alpha}$. The results will simply mirror the obtained ones, where for $\omega > f_b$, ς will be outside 1, and for $\omega < f_b$, ς will be within 1.

6.5. Testing the impact factor

This thesis proposes another way of evaluating deterrence in civil cases against insider dealing without differentiating between the financial penalty's components. It can be done by statistically examining the impact factor under DEPP 6.5C.2[G](11)(a) as an independent unit. Not only this approach will not aim to measure and eliminate disgorgement, but it will consider disgorgement as an alienable element as it mirrors the impact factor figure.

It is important to focus on this impact factor for the following reasons,

* this factor should be prevailing factor in the sense that insider dealing is about monetary benefits irrespective of whether it is in the form of gains or loss avoidance.[778] For this reason, other factors standing alone cannot initiate a discussion into deterrence, as it was discussed in chapter four,

* but after having understood this impact factor, the other factors can be added and removed to observe changes in these relationships,

The impact factor will be broken down into two variables making up such an illegal profit, namely, the total number of shares traded, or orders placed, and the spreads between the prices at which these transaction were consummated.[779] As these two elements constitute the impact factor, they should be treated as equivalent to each other as neither can exist on its own. That is, if an insider while in possession of inside information decides to deal in some financial instruments, they will do it on the basis of bid-ask spreads, i.e., the difference between buy and sell orders. Even if the insider does not deal in financial instruments but say discloses this inside information to a third party, and this third party likewise does not deal in those financial instruments, still there is a bid-ask spread at each point at which the insider(s) could carry out transactions. Should there be no financial instrument to be dealt in, then there is no relevant bid-ask spread, and *vice versa*. The expectation is that the impact factor implies the following, the bigger the total illegal benefits are the bigger should be the financial penalty. It follows that, the higher the number of shares and the wider the bid-ask spreads the larger must be the impact on the financial market. Yet little is known about these impact factor's components, their interrelationships, and whether they really influence the final figure of a financial penalty. This thesis will attempt to fill this gap by conducting this first statistical analysis of the impact factor and the severity of financial sanctions.

The data were derived from the Final Notices against individuals in civil cases of insider dealing issued by the FSA and the FCA from 2004 until 2021. Within the collected Final Notices, 31 cases were found to be containing information on all the three variables, (i) the number of shares, (ii) spreads, or price difference, and (iii) financial penalties. In some cases, especially those involving improper disclosure of inside information it was impossible to ascertain the exact number of shares traded and the bid-ask spreads. Even if the FSA and FCA

[778] See footnotes 27 and 144

[779] B Frijns, A Gilbert and A Tourani-Rad, 'Insider trading, regulation and the components of the bid-ask spread' (2008) 31 Journal of Financial Research 225

knew that information, it was not included in the Final Notices. These two variables will be measured against the magnitude of financial sanctions, which will be divided into three groups, namely, the group from £0 to less than £30,000 (i.e., 0-30K), from £30,000 to less than £80,000 (i.e., 30K-80K) and over £80,000 (i.e., >80K). These financial penalties include both disgorgement and penalties reflecting the seriousness of insider dealing.

As regards the bid-ask spread variables, or the price difference variable, all the spreads will be added up together in each case. More than two spreads in any given case will be split up by their total number to get the average number for each case. Because insiders often trade across the day or days, so it can be that an insider dealing in say 10,000 shares breaks this bunch into two, three, and so on tranches possibly experiencing different bid-ask spreads at each transaction. One case will be excluded from the test due to its bid-ask spread being significantly greater than the average spread.[780] If this bid-ask spread had remained, it could have inaccurately characterised the relationships. So the total number of cases to be statistically tested will be 30.

The number of shares variable will be calculated by adding up the number of ordered or/and executed shares. Shares in this test will be used as an umbrella term enveloping any financial instrument. Under specific conditions the number of shares will be counted twice over. Shares can be sold and then purchased by a third party, who might or not be an insider, meaning that the original number shares say is 10,000, should be multiplied by two so that the final number of shares stands at 20,000. For example, in the case of Einhorn, according to the Final Notice, the total number of was 11,650,000, but the number to be inserted in the test will be 23,300,000.[781] It is because of Osborne, the person disclosing the inside information, was also penalised for his disposal of shares, for he had not disclosed that information there would not have been either acquisition or disposal of shares.

To carry out a statistical examination of the impact factor and the magnitude of financial penalties, i.e., the severity of sanctions, a one-way ANOVA test will be conducted using IBM

[780] Philip Jabre and GLG Partners LP, Tribunal Decisions FSMT Case 035 10/07/2006 and case 036 10/07/2006. The price difference in this case was £400. Would it be an outlier and skew the data

[781] Einhorn (n 278), paragraph 2.7

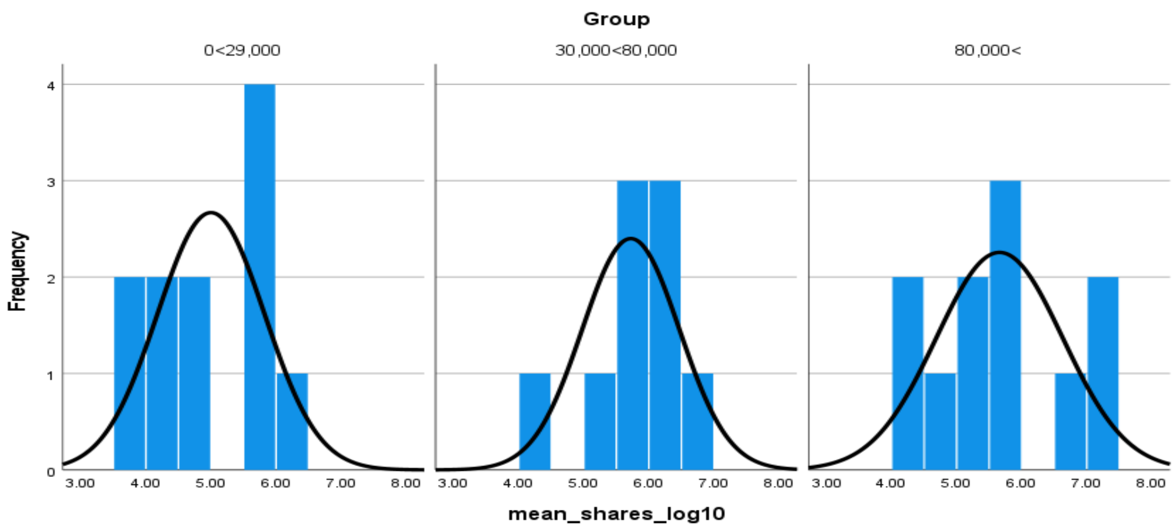
SPSS version 27. This statistical test is used to find out whether there is a difference in means between two or more independent groups.[782]

Null hypothesis: $\mu_1 = \mu_2 = ... = \mu_k$, i.e., there is no difference in the means,

Alternative hypothesis: $\mu_i \neq \mu_j$ for some $i \neq j$, i.e., there is some difference in the means.

For the one-way ANOVA test, a researcher should make sure that data are independent and normally distributed. Initially, the collected raw data were left skewed. It was confirmed by Shapiro-Wilk test with p-values < 0.05 for both the mean bid-ask spreads and the mean shares. This test is used for testing a complete sample for normality, i.e., how close data fit to a normal distribution.[783] To resolve this issue, so that the data were normally distributed, I transformed the data using a log10 transformation, so the variables will now be denoted as, mean_shares_log10 and lg10_mean_price_difference or lg10_avereage_price_dif. The following Shapiro-Wilk test confirmed that after the log10 transformation the data were normally distributed as shown in below in Figure 2 for mean_shares_log10, and Figure 3 for lg10_mean_price_difference.

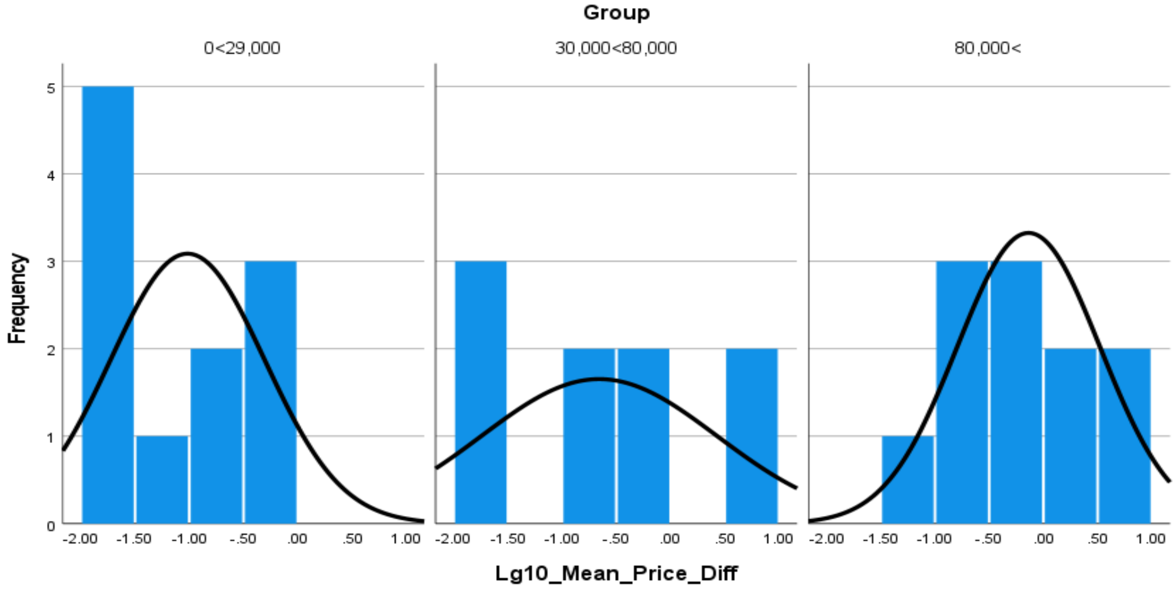
Figure 2. Mean_shares_log10 number of shares for each penalty group



[782] F J Gravetter and L B Wallnau, *Statistics for the behavioural sciences*, (10th edn, Cengage, 2016)

[783] S S Shapiro and M B Wilk, 'An analysis of variance test for normality (complete samples)', (1965) 52 Biometrika 591

Figure 3. Lg10 mean price difference



Another assumption of the one-way ANOVA that the researcher should meet is that the population variances for three or more groups are equal in the population, which is called homogeneity.

Table 9. The Levene's test for homogeneity

Tests of Homogeneity of Variances

		Levene Statistic	df1	df2	Sig.
LG10average_price_dif	Based on Mean	2.173	2	28	.133
	Based on Median	1.771	2	28	.189
	Based on Median and with adjusted df	1.771	2	22.523	.193
	Based on trimmed mean	2.139	2	28	.137
mean_shares_log10	Based on Mean	.706	2	28	.502
	Based on Median	.893	2	28	.421
	Based on Median and with adjusted df	.893	2	26.062	.422
	Based on trimmed mean	.781	2	28	.468

To test this assumption, the Levene's test for homogeneity as shown in Table 9 was deployed and confirmed that the data across the three penalty groups had equal variances.

6.6. Findings

The one-way ANOVA test observed no difference between the three penalty groups for the mean_shares_log10 at a significance level of 5 per cent, where the p-value was equal to 0.121 and the F-statistic was 2.279 as shown in Table 10 below. For lg10_average_price_dif (or lg10_price_mean_diff), the p-value was 0.057, and the F-statistic was 3.189, which could provide evidence for a statistically significant difference across the three penalty groups at a 10 per cent significance level, but not at 5 per cent. Post-hoc comparisons showed a very subtle difference between the penalty groups 0-30K and >80K and lg10_average_price_dif, where the p-value was 0.46 using Turkey HSD test, see Appendix E.

Table 10. One-way ANOVA

One-way ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
LG10average_price_dif	Between Groups	4.292	2	2.146	3.189	.057
	Within Groups	18.843	28	.673		
	Total	23.136	30			
mean_shares_log10	Between Groups	3.369	2	1.685	2.279	.121
	Within Groups	20.693	28	.739		
	Total	24.062	30			

The obtained results question the assumption that the financial penalty is greater than the illegal benefits from insider dealing as there was no significant difference observed between the three penalty groups and the two variables. This preliminary findings indicate that the impact factor standing alone does not influence the severity of a financial sanction. The problem with this is that if an insider generates a profit say at of £200.10p, which is high, but he dealt in only 100 shares that is 100 x of £200.10p approximately equals £2,010. Then, if the number of shares to be increased to say a 1,000 shares, the spread would generate around £20,100, which can be regarded as relatively big profit, but based on the findings there would not be a significant difference between the means. This upper penalty group is important because the post-hoc test attenuates some of these concerns by showing a very weak statistical significance between the penalty groups 0-30K and >80K in lg10_average_price_dif, which may be inconsequential, but the middle group does not differ between the lower and upper groups. Perhaps, it can be explained by the fact that this middle group covers both the end values of the lowest penalty group and is twice its size, and the first values of the upper group, but size-wise it is smaller. The middle group cuts through these two groups, and as a result did not observe any statistically significant relationship.

6.7. Limitations of the test

This approach has several limitations worth indicating. First, only one impact factor was used to infer the illegal gains variable influence on the severity of sanction. The purpose behind this choice was that there had been no similar research, so it was necessary to explore this factor. This thesis presumes that this impact factor is fundamental inasmuch as insider dealing is about gaining benefits. In future research it will be interesting to find out how other factors interact with the impact factor and the severity of sanctions. Moreover, it will be possible to add the certainty criterion to analyse the effectiveness of enforcement from the two deterrence criteria. Second, the information provided in the Final Notices is not always complete. Due to this fact the obtained results may have been slightly inaccurate. Third, the penalty groups sizes are unequal. This fact could tilt the findings in one direction, thereby providing inaccurate values. Fourth, compared to the two-step metric, this test did not remove disgorgement from the calculation, but if it had done, there would have been still no statistical significance between the penalty groups and the variables. Fifth, this test did not engage with criminal sanctions.

6.8. Discussion and concluding remarks

This chapter carried out an evaluation of the severity criterion of the civil regime's penalty-setting framework by putting forward a two-step metric and conducting one-way ANOVA to test the impact factor under DEPP 6.5C.[G](11)(a). This chapter carried out an evaluation of the civil regime's penalty-setting framework on the actual enforced cases, which has not been conducted heretofore in the existing academic literature. Both the tests observed that the effectiveness of insider dealing regulations has been compromised by the inconsistent application of the civil regime's penalty-setting framework diluting deterrence. More research is required in this direction.

The two-step metric was designed under the assumptions that, (i) the ambiguous nature of disgorgement and emanating from it the quantification issue, (ii) the adjustability of the penalty reflecting the seriousness of insider dealing, where the impact factor under DEPP 6.5C.2[G](11)(a), that is, 'the level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the market abuse, either directly or indirectly', can be viewed as a similar figure to that of disgorgement and (iii) the quantification issue. As a result, there is a possibility that a financial penalty being imposed can be lower than the quantified, and actual illegal gains from insider dealing which is at odds with the deterrent model of imposing a sanction greater than the amount of illegal gains. The mechanics of this two-step metric are that it first solves for disgorgement, and then for the penalty reflecting the seriousness of insider dealing.

By applying this two-step metric to the cases brought by the FSA, and later by the FCA, it was shown that in about half of the enforced cases, the imposed financial penalties were lower than the quantified amount of illegal gains. It is therefore possible to conclude that the civil regime's penalty-setting framework has been undermining the effectiveness of insider dealing regulations by imposing disproportionate penalties. In other words, while the FCA wields enormous legal powers to detect and enforce insider dealing regulations, given the challenges associated with the risk-based approach, the certainty of actual enforcement is low. Countervailing this shortcoming should be done by an increased severity of punishment, which as this metric observed was questionable.

In the second test on the impact factor under DEPP 6.5C.2[G](11)(a), was statistically observed that neither the number of shares acquired, disposed, or ordered nor the bid-ask spreads affect the severity of financial sanctions. The logic for testing this factor independently from any other factors was justified on the grounds of insider dealing being an economic-driven crime, that is, insider dealing is committed for money. Of course insider dealing can be committed inadvertently, or legally, which in their own right jeopardise the effectiveness of regulations, but it is natural to expect cases with disgorgement to be economically driven.

CONCLUSION

This thesis wanted to examine the effectiveness of insider dealing regulations in the UK by unpicking the two sets of challenges, which allowed this research to situate heretofore overlooked issues with the civil regime's penalty setting framework. Within the first set of challenges, are those challenges to enforcement associated with the nature of insider dealing and for the purposes of this PhD were regarded as being intrinsic to the concept of insider dealing, that is, ineradicable. Insider dealing is prohibited on the theoretical assumptions which are not sufficiently robust to be classed as axiomatic. This is due to the fact that there are various exemptions from and defences to insider dealing making this practice legal in certain circumstances and creating a matrix of complicated mutually inclusive and exclusive rules in which carrying out the purpose of insider dealing regulations, as it was discussed in Section 2.1.2., becomes problematic. Economically speaking, it is when insider dealing is deemed to be economically efficient, and legally speaking, it is when the FCA cannot prove insider dealing. Both legality considerations coupled with the problem of identification of inside information, as argued in section 4.9, exacerbate the proving of insider dealing in that the FCA cannot, at least constantly, be certain as to the accuracy of quantified illegal gains from insider dealing in the process of imposition of a financial sanction. On the other hand, the other set of challenges to enforcement of insider dealing regulations, are those challenges which can be rectified by the FCA, such as, the application of an effective deterrence-based enforcement strategy given approaches to insider dealing regulations together with the availability of adequate legal powers. This thesis regard such challenges as being rectifiable because as it was demonstrated in chapters three and four, the UK financial regulatory system has undergone several significant overhauls.[784]

In this connection, the research was particularly interested in exploring whether deterrence underpinning the enforcement of insider dealing regulations is a suitable response to the insider dealing threat and whether a deterrence-based enforcement strategy has been properly devised and deployed by the FCA in civil cases against insider dealing.[785] With regards to the former inquiry, it was concluded that the assumptions of deterrence are a fitting response to insider dealing, but if and only if these assumptions are correctly constructed. In particular,

[784] This paragraph is a summary of question (a)

[785] This relates to question (b)

given a relatively low certainty of enforcement of insider dealing regulations but with adequate legal powers, the severity of sanctions should be amplified. It was suggested that, when only a civil financial sanction to be imposed, that is, the criminal regime is out of consideration, there can be at least two penalties options to choose from. Fixing a financial penalty at its maximal level, or at £100,000 as it is currently under DEPP can cause a problem enforcing this financial penalty in view of the fact that not every individual will be able to afford to pay that penalty. Although, the thesis did not concentrate on the criminal regime, it was speculated that a financial sanction should likewise be set at its maximal level, and should an insider be unable to afford to pay off the financial penalty, a custodial or suspended prison sentence should be activated. In both scenarios, the enforcement of maximal financial sanctions is problematic with the difference being that in the latter setting the impossibility of enforcing a maximal financial penalty can lead to the criminal regime being overused and undermined with the corresponding decrease in value of the civil regime and increased enforcement costs.[786] As regards the civil regime, the impossibility of enforcing maximal financial sanctions can likewise compromise the deterrent effect, therefore, this thesis advised the following deterrent structure, a civil financial sanction should be at least greater than the quantified illegal gains. But in order to attain such an equilibrium a quantification issue should be determined and the civil regime's penalty-setting framework under DEPP analysed. To sum up, the effectiveness of insider dealing regulations pivots on the success of a deterrence-based enforcement strategy, which if improperly employed will undermine the deterrent effect and therefore there cannot be effective regulations.[787]

This thesis put forward a trailblazing theoretical two-step metric for evaluating a deterrent effect from the enforced civil financial sanctions, that is, the severity of penalty. The severity criterion was relied on this thesis for inferring the deterrent effect for the following reason. In chapter three it was shown that there is a little difference between the civil and criminal regimes against insider dealing. In particular, in terms of the certainty criterion, it was argued that the standards of proofs between the regimes are identically high in insider dealing cases. Likewise, the length of investigations does not significantly differ between the regimes. But it is the severity criterion that bifurcates this thin line between the civil and criminal regimes, which was evaluated within this research.

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[786] Polinsky and Shavell (n 723)

[787] This relates to question (c) and (e) and question two

To sum up, this approach is pioneering in that it suggests applying an economic model to a topic that is not usually investigated using algorithms. It is justified for a number of reasons, such as, this two-step metric is flexible in that it rests on the discussed challenges to enforcement which for the purposes of the calculations are considered as the underlying assumptions. Furthermore, situating disgorgement is an arduous task as it was argued in chapter five, but since it is a challenge to enforcement it is transformed into an assumption under the two-step metric and therefore can be observed in the enforced civil cases against insider dealing.[788] The two-step metric therefore evaluates the deterrent effect not from the mere enforcement rates, but through the actual imposed financial sanctions. Reasonably, since financial sanctions are pecuniary, the best way to evaluate them and the corresponding deterrent effects is from applying algorithms with certain in-built assumptions. Although this two-step metric within this thesis is restricted to civil cases in which both financial penalty's components have been deployed, owing to the flexibility of assumptions the two-step metric can be extended to criminal cases including other disciplinary and administrative sanctions. The assumptions supporting the two-step metric can be reduced to the overarching quantification issue, which was discovered and developed throughout the thesis.[789] The quantification issue emerges from the social-welfare argument according to which it is plausible to regard everyone as a potential victim of insider dealing. In the conclusion to chapter two, the fundamental argument supporting the quantification issue was posited in which, one wishing to legalise insider dealing should first devise a methodology which will reliably gauge gains and losses of informed and uninformed investors. But what is more important is to figure out how should the investors' estimation of the values of the generated benefits be scaled. Both of these considerations give rise to the quantification issue under which it is impossible to know and estimate the quantity of pieces of price-sensitive inside information in circulation, and by extension the actual total illegal gains from insider dealing. This challenge is not surmountable inasmuch as it is an intrinsic element to insider dealing, but it can be alleviated by the deployment of an effective deterrence-based enforcement strategy. Therefore, the quantification issue is further premised on the following considerations,

(1) insiders can falsify their accounts, i.e., conceal their true amounts of generated illegal gains,

[788] Gibbs (n 548), Lessig (n 612), Bandura (n 613), Lichtenstein and others (n 614), Geis and Szockyj (n 658)

[789] This relates to question (d)

(2) identification of inside information is problematic for persons creating, co-creating or in possession of inside information,

(3) legality and illegality of insider dealing complicates the proving process,

(4) knowledge of alleged insiders on the fact that they are in possession of price-s sensitive inside information, and

(5) the risk-based approach to enforcement, i.e., not every instance of insider dealing will be investigated,

In light of the quantification issue, the critical analysis of the FCA civil penalty-setting framework revealed the ambiguous nature of disgorgement, as a component of a civil financial sanction.[790] While disgorgement is not indispensable element of a financial penalty, as it was pointed out in section 4.10.1. and section 6.3., as it is active only if the FCA is able to quantify the amount of illegal gains from insider dealing, but disgorgement affects the penalty reflecting the seriousness of insider dealing (the PRSID) through the impact factor under DEPP 6.5C.2(11)(a). The two-step metric builds on the assumption that the disgorgement figure represents not only the penalty component, but also the amount of illegal gains quantified by the FCA. Therefore, the disgorgement should never be higher than the PRSID, otherwise, the deterrent effect of a financial sanction is compromised. To conclude, while the thesis argued that deterrence is a suitable response to the insider dealing threat, which for the purposes of this thesis fell under the rectifiable set of challenges, has been undermined by the quantification issue which is the ineradicable challenge to enforcement and the ambiguous nature of disgorgement under the existing civil regime's penalty-setting framework against individuals, which is a rectifiable challenge.

Although, the two-step metric is restricted to the specific class of cases within the civil regime, it has proven to be a powerful tool for inferring a deterrent effect from financial sanctions. The results are promising, but more adjustments and enhancements are needed to finalise its application. This thesis made the first step to devising this model, in future research it is suggested that criminal sanctions will be incorporated into the metric to observe the variances between the sanctions. Likewise, it will be interesting to devise an optimal financial sanction on the basis of the propounded deterrent rate.[791]

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[790] This relates to question (f)

[791] This relates to question (g)

Having applied this two-step metric to the selected enforced civil cases showed that in around half of these cases, the financial penalties were lower than the quantified illegal gains which contradicts to the assumptions of deterrence theory. Thus, insider dealing regulations in the UK, given the discussed challenges and as the findings obtained from the two-step metric, are not effective on the foot of the proportionality principle,[792] i.e., a financial sanction can be lower than the quantified illegal gains thence would-be insiders' cost-and-benefit considerations are not positively incentivised.

This thesis proposed another way of evaluating the effectiveness of insider dealing regulations through the lens of deterrence by breaking down the impact factor under DEPP 6.5C.2(11)(a). Insider dealing is an economic-driven crime; hence this impact factor should be the prevailing factor even standing alone since it is about the level of illegal gains generated by insiders. This thesis's examination made the first step to understanding the role and working of these factors by means of a one-way ANOVA test showed no statistically significant relationship between the impact factor's variables, (i) the number of shares acquired, disposed of, or orders placed, executed, amended or cancelled and (ii) the bid-ask spreads and the three penalty groups. This finding further questions the effectiveness of insider dealing regulations as the higher profits are not necessarily associated with the severe sanctions in civil cases. Of course there can be other factors, or a combination of factors which produce a more severe outcome, and it will be interesting to explore in future research how for example the other factors under DEPP, see Appendix C, influence the severity and possibly the certainty criteria. The problem with this approach, as it was with the two-step metric, and possibly will be persistent in future studies is that there is incomplete information as to the relevant data.

Similarly to the two-step metric, this alternative methodology for evaluating the effectiveness of insider dealing regulations by situating deterrence within the impact factor can be a powerful estimator and predictor for the severity of sanctions. The thesis made the first step towards unpacking the potential of various statistical tools to be used in law which should be expanded in future research. For example, criminal sanctions and other factors, including those from the certainty criterion can be included into future studies.[793]

This thesis could not carry out all the tests due to several reasons. First, the purpose was to conduct what the author believed to be the first-of-its-kind evaluation of the civil regime's

[792] DEPP 6.5.3[G](3), and Enforcement Guide 2.1.2(2)

[793] This relates to question (h)

penalty-setting framework against individuals based upon a number of challenges to enforcement. The purpose was to determine whether insider dealing regulations in the UK are effective. In view of the fact that, there have been no similar studies, this research was no other choice but to build its arguments from the ground up, that is, from scratch. This was important not only for the reason indicated, but also it is essential to know the basic, the fundamental relationships between the challenges to enforcement on which further research can be expanded on. Second, although, during the research, the author wished to elaborate on the challenges and the metrics, but it was not feasible to carry out for the limitations imposed on the PhD by the University's rules and requirements, such as, the time and word count limitations.

In closing, this thesis has made the first step to innovatively examining and evaluating the challenges to enforcement through the lens of deterrence by analysing the enforced civil cases against insider dealing.

Appendix A[794]

Criminal Cases from 2003 till 2023

C/I	Case	Background
1/4	*R v Spearman and others* [2003] EWCA Crim 2893; (Payne, Smith, Spearman and Spearman) **Sentence**: Smith pleaded guilty and was sentenced to 18 months' imprisonment, ordered to pay £36,012 by way of confiscation and to pay £50,000 towards the cost of the prosecution. Spearman sentenced to 18 months' imprisonment, ordered to pay £107,935 by way of confiscation and to pay £50,000 towards the cost of the prosecution. Payne was sentenced to 21 months (after appeal). R Spearman was found guilty of conspiracy to commit insider dealing, sentenced to 30 months' imprisonment and ordered to pay £169,000 by way of compensation. On trial. **Profit**: Smith approximately £36,000; C Spearman profit more than £100,000, R Spearman profit around a quarter of a million pounds	Payne was a proof-reader at Burrups Ltd. His activity was to print price-sensitive brochures for City mergers and takeovers. He passed on the information to his friends Smith and Spearman, and they in turn informed Spearman of the details. The latter then embarked on a buying of the shares in question. <u>Committed between 1997 and 2001.</u>
2/5	*R v Beale, Judson, Masters, Butt and Coleman*, (Southwark Crown Court, 17 March 2004) *R v Asif Nazir Butt* [2006] EWCA Crim 137, CA 12 January 2006 **Sentence**: Beale and Judson were sentenced to two years, Masters was sentenced to 12 months, Coleman to nine months, and A. Butt sentenced to five years. On trial. **Profit**: £388,488	Butt was a vice-president of compliance at Credit Suisse First Boston. His position existed to ensure the secrecy of dealings. However, he passed on the information to friends, Beale, Coleman, Judson and Masters who either bought shares or placed spread bets of up to £600,000 before important financial announcement. It was claimed that as there were many other similar transactions not mentioned in court, the actual figure was probably much larger. <u>Between July 1998 and January 2002</u>.
3/2	***R v McQuoid [2009]* EWCA Crim 1301** **Sentence**: McQuoid 8 months, Melbourne 8 months suspended for 12 months, £30,000 towards the cost of the prosecution and was subject to a £35,000 confiscation order. On trial.	McQuoid is a solicitor and was the former General Counsel of TTP Communications Plc. During the course of his employment, he became aware of insider information about a proposed takeover by Motorola Plc. He was convicted for having transferred the information to Melbourne. The latter acquired just under 154, 000 shares in the company at 13

[794] C/I means cases and individuals

	Profit: approximately £50,000	pence per share on 30 May 2006. The sum paid in total was £20,301.60. On 1 June 2006, the takeover bid became known to the market. The price rose to 45 pence per share.
4/2	*R v Power and Carlisle*, Unreported, His Honour Judge Wadsworth QC 29 February 2009 **Sentence**: Carlisle acquitted; Power spent 5 months in custody and sentenced to 18 months suspended. On trial.	The accusations of flouting City rules led to a lengthy investigation by the Department of Trade and Industry and took 12 years to come to trial. Lowe gave Power away to the LSE by reporting about his leaking relating to the £9.7 million takeover of the Belgo chain 1997.
5/3	*R v McFall, King and Rimmington*, (Southwark Crown Court, 11 May 2010) **Sentence**: were acquitted	Lawyers McFall and Rimmington were accused of generating £80,000 by acquiring shares in NeuTec Pharma ahead of a takeover by Novartis. They allegedly got inside information from King, a NeuTec director. Allegedly committed in June 2006.
6/2	*R v Neel and Matthew Uberoi*, (Southwark Crown Court, October to 6 November 2009) *R (Uberoi) v City of Westminster Magistrates' Court and FSA* [2009] 1 WLR 1905 **Sentence**: N. Uberoi to 2 years of imprisonment, and M. Uberoi sentenced to 12 months imprisonment. On trial. **Profit**: £110,000	During the summer of 2006 Uberoi was an intern at a corporate broking company working on takeovers and other price-sensitive transactions. He slipped inside information to his father in relation to deals in three companies. His father then purchased shares in those companies.
7/1	*R v Calvert*, (Southwark Crown Court, 7 May 2010) **Sentence**: imprisoned for 21 months. On trial. **Profit**: £103,588	Calvert made use of inside information to invest £502,143 in the shares of three companies that were the subject of non-public takeover bids. Committed April 2004 till March 2005.
8/1	*R. v Rollins* [2010] UKSC 39, [2010] 1 W.L.R. 1922 **Sentence**: 15 and 21 months sentences (to run concurrently) further 6 months consecutive sentence for money laundering. On trial. **Profit**: £120,000	Rollins was charged with 4 counts of insider dealing contrary to s. 52 (1) of the CJA 1993, 1 count contrary to s. 52 (2) (a) of the Act and 4 counts of money laundering contrary to s. 327 (1) (d) of the Proceeds of Crime Act 2002. Having inside information which related to PM Group plc, he disposed of 20,000 shares on 22 August 2006, 10,000 shares on 23 August 2006, 30,000 shares on 6 September 2006 and 13,989 shares on 13 September 2006. Apart from committing these, he also encouraged L Rollins to deal in shares in PM Group plc.
9/1	*R v Ahmad*, (Southwark Crown Court, 22 June 2010) **Sentence**: 10 months suspended for 2 years. Also, £ 50,000 fine and 300 hours of community service, and disgorgement of £131,000. Guilty plea. **Profit**: £131,000	Between 15 May 2009 and 22 August 2009 Sidhu (see below) in cahoots with A. Ahmad, an ex-hedge fund trader and risk manager at AKO Capital LLP, dealt in the18 different UK and European listed shares, based on inside information obtained by Ahmad in his role as a trader at AKO

10/1	*R v Rupinder Sidhu*, (Southwark Crown Court, 15 December 2011) **Sentence**: 24 months. On trial. **Profit**: approximately £524,000	He placed bets in relation to those securities (see above).
11/3	*R v Littlewood and Littlewood*, (Southwark Crown Court T20107298, 2 February 2011) *R v Littlewood and Littlewood*, (Southwark Crown Court, 10 January 2011) **Sentence**: The first defendant was sentenced to 3 years and 4 months, the second was sentenced to a suspended term of 12 months, and the third individual was sentenced to 24 months. Guilty pleas. **Profit**: approximately £590,000	Littlewood was a senior investment banker and former FSA Approved Person, his wife A. Littlewood and a family friend Sa'aid. The offences relate to trading in a number of different LSE and AIM listed shares between 2000 and 2008.
12/2	*R v Hossain and Buck*, (Southwark Crown Court, 20 June 2012) **Sentence**: acquitted	It was alleged that he had traded personally and encouraged Blue Index clients to trade in derivatives in U.S. stocks prior to takeovers. The total profits generated by these trades were **alleged to exceed £12 million**. This was a particularly complex cross-border case, involving a substantial amount of evidence requiring exceptionally sedulous analysis of evidence gathered in the UK and the U.S. (See below)
13/3	*R v Sanders, Sanders, and Swallow*, (Southwark Crown Court, T20110222 20, June 2012) **Sentence**: J Sanders sentenced to 4 years imprisonment plus director disqualification order for 5 years; M Sanders and Swallow (£440,000) were sentenced to 10 months. Guilty pleas. **Profit**: approximately £1.9 million; while the total profits generated by the clients of Blue Index were ≈ £10.2 million	Sanders was director of Blue Index, a specialist Contract for Difference (CFD) brokerage. His wife Sanders, and co-director of Blue Index Mr. J. Swallow. A. McClellan was a senior partner in a large US accounting firm was an insider to a number of mergers and acquisitions in US securities listed on the NYSE and NASDAQ exchanges. The inside information was leaked by him, M. Sanders' brother in law, or her sister McClellan, and passed to J. and M. Sanders who used the information to commit insider dealing in those US securities. J. Sanders also disclosed information to others including Swallow, who used that information to commit insider dealing. In addition, Sanders encouraged clients of Blue Index to trade in CFDs on the basis of that inside information. The FSA seized 800 thousand calls. Between October 2006 and February 2008.
14/6	*R v A. Mustafa, P. Saini, P. Shah, N. Shah, B. Shah and T. Patel*, (Southwark Crown Court T20107296, 27 July 2012) **Sentence**: A. Mustafa, P. Saini, and P. Shah were sentenced to 3 and half years imprisonment, N. Shah to 18 months,	The defendants obtained confidential and price-sensitive information from investment banks concerning proposed or forthcoming takeover bids. They then used a large number of accounts to place spread bets ahead of those announcements knowing that when the information became

	B. Shah and T. Patel for 2 years imprisonment, a Confiscation Order £3,249,488.71. On trial. **Profit**: approximately £732,044	public knowledge the price would rise. <u>Traded between 1 May 2006 and 31 May 2008</u>.
15/3	*R v T. Amman*, (Southwark Crown Court, 15 November 2012) *R v T. Amman, C. Weckwerth and J. Mang*, (Southwark Crown Court, 24 May 2012) **Sentence**: Weckwerth and Mang were acquitted and were permitted to keep profits. T. Amman was sentenced to 2 years and 8 months in prison. Guilty plea. **Profit**: Overall approximately is £1,500,000, T. Amman's is approximately	Amman was an investment banker working at Mizuho International plc. In late 2008 and 2009 MIP was advising Canon, on its acquisition of Oce, a medium sized Dutch company making photocopiers etc. By virtue of his employment at MIP, he had access to inside price-sensitive information relating to the takeover. Rather than dealing in his own name, he encouraged two women Weckwerth and Mang, to buy shares prior to the acquisition. <u>Between 2008 and 2009</u>
16/1	*R v Milsom,* (Southwark Crown Court, S20113002, 17 March 2013) **Sentence**: Imprisoned for 2 years, and confiscation order was also made in the sum of £245,000. Guilty plea. On 27 April 2020, the FCA made an order PXM01330 pursuant to s. 56 FSMA 2000, prohibiting him from performing any function in relation to any regulated activities **Profit**: over £30,000	Milsom was an approved person employed by Legal and General Investment Management (Holdings) Ltd. He disclosed inside information relating to forthcoming transactions in securities by LGIM. <u>Between October 2008 and March 2010</u>
17/1	*R v R. Joseph*, (Southwark Crown Court, 1 March 2013) FSA/PN/023/2013 **Sentence**: Imprisoned for 4 years. On trial. **Profit**: £591,117	Traded between <u>September 2007 and July 2008</u>. He was provided with confidential and price-sensitive information from two investment banks concerning proposed or forthcoming takeover bids. Information was provided to him by Mustafa (see above). Having received this information, he placed spread bets in the expectation that when the information became public knowledge the share price would rise, and he would make a profit
18/1	*R v Shelley* (Southwark Crown Court, 2014) **Sentence:** Sentenced to 2 year suspended sentence and ordered to repay £588,000 **Profit**: £591,117	Joseph a former futures trader, was provided with confidential and price-sensitive information from two investment banks concerning proposed or forthcoming takeover bids. The information was provided by Mustafa (see above). Shelley was a broker at Novum Securities, and Milsom (see above)
19/1	*R v Julian Rifat*, (Southwark Crown Court, T20140073,19 March 2015) **Sentence**: Sentenced to 19 months imprisonment, also was fined £100,000 and ordered to pay costs of £159,402. Guilty plea. On 1 September 2020, the FCA made an order pursuant to s. 56 FSMA 2000, prohibiting him from	Rifat was a senior execution trader at Moore Europe Capital Management LLC. He passed inside information, obtained during of his employment, to an associate, Shelley, who then traded for their joint benefit (see above)

	performing any function in relation to any regulated activities **Profit**: more than £250,000	
20/1	*R v Willmott*, (Southwark Crown Court, 27 March 2015) **Sentence:** 10 months, £6,122 towards prosecution costs and a Confiscation Order in the sum of £23,239. On trial. **Profit**: £12,000	Dealt on the basis of inside information he obtained during the course of his employment relating to the takeover of Logica PLC by CGI Group. He set up a trading account in the name of a former girlfriend, without her knowledge, to carry out the trading. He also admitted disclosing inside information to a family friend Craver see the civil cases. Committed in May 2012
21/1	*P. G. Cole*, (Leeds Crown Court, U20150204/T20147248 3 May 2015) **Sentence***:* sentenced to 12 months imprisonment, also ordered to pay £15,000 towards prosecution costs and a Confiscation Order in the sum of £203,234. Guilty plea. **Profit**: more than £79,000	Cole was the former Group Treasurer and Head of Tax at Wm Morrison Supermarkets plc. Between 24 January and 17 May 2013 he through his role at Morrisons, was regularly privy to confidential price sensitive information about Morrisons' ongoing talks regarding a proposed joint venture with Ocado Group plc. He took advantage of this information by trading in Ocado shares
22/4	*R v Dodgson, Parvizi, Anderson and Hind* (Southwark Crown Court, T20127434, 12 May 2016) **Sentence***:* M. Dodgson 4, 6 years, A. Hind 3, 6 years. I. Parvizi and B. Anderson were acquitted. After trial. **Profit**: £7.4 million	Ex-Deutsche Bank corporate broker Dodgson and accountant Hind. Between November 2006 and March 2010. It was a nine-year long investigation. The group were accused of using high-end encryption systems and unregistered pay-as-you-go mobiles to cover their activity
23/1	*R v Harrison*, (Southwark Crown Court, T20127434) **Sentence**: acquitted	See above
24/1	*R v Clarke*, (Southwark Crown Court, March 2016) **Sentence**: to 2 years imprisonment. On trial. **Profit**: more than £150,000	He was a former equities trader at Schroders Investment Management. From October 2003 to November 2012 he used inside information – such as an anticipated announcement of mergers and acquisitions
25/2	*R v Mohal and Birk,* (Central Criminal Court, 13 January 2017) **Sentence**: Mohal to 10 months suspended for two years, and 180 hours of community work. Birk to 16 months suspended for two years and 200 hours of community work **Profit**: over £100,000	Mohal worked at Logica he came into possession of inside information in relation to a takeover of Logica, which he disclosed to his neighbour, Birk, and another individual, who was cleared. Committed in May 2012
26/1	*R v Baldwin,* (Southwark Crown Court*,* 3 September 2019) Sentence: 5 years and 8 months	Baldwin was a business partner of Hind (see the case above No 22). At the moment of writing up this list of cases Baldwin

	Profit: around £1,500,000	remains at large. Committed between November 2006 and March 2010
27/2	*R (FCA) v Abdel-Malek and Anor* [2020] EWCA Crim 1730 **Sentence**: both to 3 years imprisonment **Profit**: approximately £1,400,000	Abdel-Malek worked as a senior compliance officer at UBS AG, and used her position to identify inside information, which she passed on to her family friend Walid Choucair, an experienced day trader of financial securities. Committed between June 2013 and June 2014 in relation to five potential acquisitions
28/2	Stuart Bayes and Jonathan Swann **Currently at a trial**. A trial scheduled for 11 September 2023 **Profit**: £138,700	Committed between May 2016 and June 2016.
29/2	Mohammed Zina and Suhail Zina **Currently at a trial**. A trial scheduled for September 2023 **Profit**: £142,000	Committed between July 2016 and December 2017.

Appendix B[795]

Civil cases from 2004 and 2023

c/p	Name of the cases	Penalty	Background
1/1	R Middlemiss 10 February 2004 **Loss avoidance** £6,825	£15,000 reduced from £20,000	The company secretary at an AIM listed company, came into possession of a profit warning regarding the company and sold some of his own shareholding in the company before this news was announced to the market. Committed on 26 April 2002. No of shares 70,000. The price difference 975p
2/1	*P Bracken* 7 July 2004 **Profit**: £ 2,824	£15,000	Breached the company's rules by dealing in its shares without permission. He engaged in short-selling the company's shares, in the hope they can be bought back when the price has fallen and generating a profit on the difference. Committed in November 2002 No of shares 5,000 and 3,000. Short sold at 190p, after the first announcement repurchased the shares at 138p. Before the second announcement short sold 3,000 at 123p, after the second announcement repurchased at 107p
3/1	*M Davies* 28 July 2004 **Profit**: £ 420	£ 1000	The offender made a small purchase of BMG shares just prior to the announcement and sold them shortly after. Committed in January 2004
4/2	*J Smith* and *R Hutchings* 13 December 2004 **Profit**: £ 4,924	£15,000 £18,000	The offender was a chartered accountant and the finance director and company secretary of IFG. In April 2003, he tipped his friend (Hutchings) that IFG was going to release a holding announcement the following morning relating to a takeover approach. Several days later, he again tipped Hutchings that a final announcement of an agreed offer was imminent
5/1	*D Isaacs* 28 February 2005 **Profit**: Unknown	£15,000	The offender was visiting the house of his friend Mr. X, who was an employee of Trafficmaster, when he read a confidential document which contained positive news about one of Traffickmaster's key products. Thereafter, Mr. Isaacs bought shares in Trafficmaster and at the same time posted strong hints about this information anonymously on the ADVFN bulletin board, presumably in order to 'ramp' the share price. Committed in September 2003
6/1	Mr. *A. Mohammed* 18 May 2005 Tribunal decision FSMT Case 012, 29 March 2005	£10,000	The offender was an auditor employed at PwC, was involved in auditing the accounts of a particular division of an LSE listed company. He purchased shares in the company at a time when he knew through his professional tasks that it was finalising a probable sale of the division. Committed in November 2002

795 c/p stands for cases and persons

	Profit: £ 3,750		
7/1	*J Malins* 20 December 2005 **Profit**: £ 6,400	£25,000	The offender was Cambrian's Finance Director. He purchased shares in Cambrian Mining Plc ahead of two positive announcements. Committed in March 2005
8/1	*P Jabre* and *GLG Partners LP* Tribunal decisions FSMT Case 035 10/07/2006, and case 036 10/07/06 01 August 2006 **Profit**: £500,000	£750,000	In this case principles of vicarious liability were applied. Jabre, on behalf of the GLG Market Neutral Fund which he managed for GLG, improperly short-sold ordinary shares in Sumitomo Mitsui Financial Group Inc the value of $16 million ahead of an announcement of a new issue of convertible preference shares in SFMG. There were eight separate trades, on three successive dates. Committed from May to July 2004
9/1	*J Boyd Parker* James Parker v FSA, FSMT Case 037, 2006 6 October 2006 **Profit**: £121,742	£250,000	The offender was a chartered accountant who was at the relevant time employed by Pace Micro Technology Plc as its credit risk and treasury manager. He learned on 27 February 2002 that a possible takeover of Pace by a much larger competitor had been abandoned and that Pace, for other reasons, was very likely to issue a profit warning. Between then and the publication of the profits warning on 5 March 2002 he sold holdings of shares in his and his wife's names, adjusted spread bets he had previously placed and placed new spread bets.
10/1	*B C Hatcher* 13 May 2008 **Profit**: £56,098	£56,098	Penalty equal to disgorgement (see *R v Calvert* case in Appendix A)
11/1	*J Shelvin* Tribunal decision FSMT Case 060 12/06/08 01 July 2008 **Profit**: £ 38,472	£85,000	On 10 January 2006 Shelvin sold a CFD equivalent to 80,000 shares at a price of 266.02 pence. His trade was made on the basis of inside information which he had obtained whilst employed as an IT technician at the Body Shop. He had been given passwords which allowed access to the email accounts of certain senior executives of the Body Shop. This enabled him to read their confidential emails which contained the relevant inside information.
12/1	*S Harrison* 8 September 2008 **Profit**: € 44,000	€ 52, 500	The offender was an investment manager at Moore Europe Capital Management Limited. On 28 September 2006 he was given inside information in respect of the imminent refinancing of Rhodia SA bonds. Later on the same day he instructed a colleague to buy up to 10 million Rhodia 10.50% Senior Notes, in the knowledge that there was to be an imminent refinancing by Rhodia which would involve their tendering for those bonds at a premium to the market price
13/1	*R Ralph* 12 November 2008	£ 117,691	The offender was appointed Executive Chairman on 14 August 2006 of Monterrico Metals Plc, and by November 2006 he was actively involved in takeover discussion for the company. He dealt in e company's shares on the basis of inside information

	Profit: £ 12,691		and disclosed inside information to another person otherwise than in the proper course. On or about <u>28 January 2007</u> he asked a friend, F Boyen to buy shares in the company on his behalf to the value of £30,000, thereby recklessly disclosing inside information to the latter. He did so during a takeover period, shortly before the announcement on <u>5 February 2007</u> of an agreed takeover offer
14/1	*F Boyen* 12 November 2008 **Profit**: £ 29,482	£ 81, 982	See above
15/1	*E Boyen* 12 January 2009 **Profit**: £ 127,254	£ 176, 253	See above
16/1	*S McKegg* 16 December 2008 **Profit**: £ 14,411	£ 14, 411	The offender was a private retail investor. One of the stocks that he regularly dealt in was Amerisur Resources Plc, which was then named Chaco Resources Plc. Blue Oar Securities Plc was the appointed NOMAD for Amerisur and also acted as a broker for Amerisur in a share placing which took place in <u>May 2007</u>. On <u>23 May 2007</u> Blue Oar contacted McKegg and made him an insider in relation to a placing of Amerisur shares to be announced to the market on <u>24 May 2007</u>. In the course of this conversation, Blue Oar advised him that the placing was 6 pence that the placing would be announced the next day and that McKegg was not permitted to speak to anyone about the placing nor trade until it was announced to the market on the next day. Following receipt of this inside information the sold 549,000 Amerisur shares, which constituted his entire shareholding in Amerisur at 8.625 pence per share. Then he purchased 750,000 shares at price 6 pence per share in the placing. Following the announcement of the placing on <u>24 May 2007</u>, the price of Amerisur's shares fell to 7.5p. <u>Committed in May 2007</u>
17/1	*B V Taylor* 16 December 2008 **Profit**: £ 4,462	£ 4, 642	Similar to McKegg (see above). <u>Committed in May 2007</u>
18/2	*D L Clifton OBE* and *Byron Holdings Ltd* 27 January 2009 **Profit**: Unknown	£59,900 £86,030	Clifton was a founding Director of Desire Petroleum plc and also a director and shareholder in Byron Holdings. He became aware of positive inside information relating to Desire. He directed Byron Holdings to purchase shares in Desire prior to the announcement of the information. <u>Committed from November 2007 till February 2008</u>
19/2	*D Morton* and *C Parry* 6 October 2009	Public Censure	Improper disclosure in relation to Barclays Bank Floating Rate Notes (FRN) ahead of a new Barclays FRN issue, in circumstances in which he was in possession of inside information regarding the new issue. Morton made representations on the market practice prevalent at the time and also submitted that he believed on reasonable grounds that his conduct did not amount to market abuse. Thus, the FSA took the view that a public censure was the appropriate penalty. Mr. Perry colleague of Morton was also publicly censured for executing the sales in question. <u>Committed 15 March 2007</u>

20/1	*A Krilov-Harrison* 3 November 2009 **Profit**: Unknown	£24,000	The offender was employed as a broker by Pacific Continental Securities (UK) Limited. In March 2007, he obtained inside information regarding an impending announcement that Provexis plc, an AIM listed company, had entered into a collaboration agreement with a major international company. He improperly disclosed this inside information to clients of PCS, and also encouraged these clients to purchase shares in Provexis
21/1	*M Lockwood* Reference Number MXL01331 1 September 2009	£20,000	He failed to identify a transaction and for not reporting the transaction to the FSA which allowed the firm to be used for the purpose of an insider dealing transaction. Committed in May 2007
22/3	*M Sepil*, *M Ozgul,* and *L Akca* 12 February 2010 **Profit**: £267,005 £35,240 £10,062	£ 967,005 £105,240 £94,062	The General executives of Genel Enerji A.S. were actively involved in a joint venture project between Genel and Heritage Oil plc, which is listed on the LSE. The joint venture concerned the exploration of an oil field in Kurdistan. By 4 May 2009, the Genel executives were aware that the exploration tests had gone well and, on 4 or 5 May 2009, all three person purchased shares in Heritage. On 6 May 2009, following the announcement of the successful testing, Heritage's share price rose substantially. Later that day, they sold their shares at a profit.
23/2	*R Chhabra* and *S Patel* Tribunal decision FSMT Case 036, 29/12/12 16 April 2010 **Profit**: £ 85, 541	£95,000 £180,541	The offender was a research analyst at Evolution Securities Limited and was responsible for covering two companies named Ebookers plc and Eidos plc. Chhabra obtained information regarding both companies which he improperly disclosed to his friend Patel, who placed spread-bets referenced to these stocks. Committed in May 2004
24/2	*J Burley* and *J Burley* 19 July 2010 **Profit:** 21,700	£ 144, 200 £35,000	The offender acquired inside information regarding a mining company. He improperly disclosed this information to a Mr. X and his father, Burley, and then instructed his father to sell his shares prior to the announcement of this information. Committed in June 2009
25/1	*A J Scerri* Tribunal decision FIN/2009/0016 20 October 2010 **Profit**: £ 46,062	£66,062	The case concerned the selling, by Scerri of stock in an AIM listed oil and gas exploration company Amerisur on the basis of inside information about a forthcoming discounted placing. Committed on 23 July 2009
26/1	*P J Bliss* 14 December 2010	£30,000	The offender was a broker at Pacific Continental and engaged in conduct similar to that of Krilov-Harrison, and Coppin. Committed in March 2007

27/1	*W J Coppin* 14 December 2010	£70,000	
28/1	*Massey v FSA* [2011] UKUT 49 (TCC) Upper Tribunal reference FIN/2009/0024 27 February 2011 **Profit**: £ 111,471	£150,000	Massey was in possession of inside information concerning Eicom plc a company then listen on the AIM. By a series of emails he agreed with Eicom that it would hold the offer to issue the shares open. Then Eicom issued a RNS announcement stating that the company had issued 4,283,740 shares. After that, he made misleading statements to his employer and his employer's compliance consultant as to the circumstances surrounding the transaction, including stating that he barely knew Eicom when he had in fact previously worked. <u>Committed in November 2007</u>
29/1	*C Agnew* Reference Number CJA01049 3 October 2011	£65,000	He failed to identify and act on a suspicious order that allowed his firm to be used to facilitate an insider dealing transaction. <u>Committed in June 2009</u>
30/1	*D Einhorn* and *Greenlight Capital INC* 15 February 2012 **Profit**: £638,000	£3,638,000	Einhorn had instructed Greenlight's traders to dispose of part of its holding in a company named Punch Taverns plc and that that instruction was given on the basis of inside information that Einhorn had received during a telephone call with Merrill Lynch International, in which he was informed of a forthcoming substantial new equity issuance by Punch. The FSA considered that his behaviour was attributable to Greenlight on the basis that he was the sole owner, the President, and sole portfolio manager, and was responsible for all Greenlight's investment decisions. <u>Committed in June 2009</u>
31/1	*A Osborne* 15 February 2012	£350,000	In <u>June 2009</u> Osborne was a Managing Director in the Corporate Broking group of Merrill Lynch International. In <u>May and June 2009</u>, he led the corporate broking team at MLI in acting for Punch (see above section) as joint book runner and co-sponsor in relation to a transaction to issue new equity. He arranged a conference call on a non-wall crossed basis between Greenlight and Punch management to take place on <u>9 June 2009</u>. During this call, he disclosed information concerning the Transaction to Greenlight. The insider information disclosed by him was that Punch was at an advanced stage of the process towards the issuance of a significant amount of new equity. As a result of the Punch Call, Greenlight proceeded to sell shares in Punch.
32/1	*N J Kyprios* 13 March 2012	£210,000	The wrongdoer was the Head of Credit Sales at Credit Suisse Securities (Europe) Limited. He improperly disclosed information relating to a potential large Eurobond issue by Credit Suisse's client Liberty Global Inc, the proceeds of which were likely to be used in part to fund Liberty's acquisition of a German cable television company named Unitymedia. <u>Committed in November 2009</u>
33/1	*M Coscia* 3 July 2013	\$ 903,186 ≈ £597,933	Coscia engaged in a form of manipulative trading known as 'layering'. The trading activity related to High Frequency Trading, in Commodities Futures, on ICE. Coscia placed and rapidly cancelled large orders which he did not intend to trade with the intention of creating a false impression as to the weight of buyer or seller interest

			thereby 'layering' the order book and manipulating market. Committed in September and October 2011
34/1	*R Shah* 13 November 2013	£124,000	Shah encouraged another person to engage in behaviour which, if engaged in by Shah, would amount to market abuse. Committed in June 2010
35/1	*Canada Inc* (Swift Trade Inc) FS/2011/0017, FS/2011/0018, FN 7722656 [2013] EWCA Civ 1662 Case No: A3/2013/0626 24 January 2014	£8,000,000	Between 1 January and 4 January 2007, Swift Trade systematically and deliberately engaged in a form of manipulative trading activity known as layering, in relation to shares traded on the LSE
36/1	*M Stevenson* FCA Reference No MAS01168 20 March 2014	£662,700	Stevenson was employed by Credit Suisse Securities (Europe) Limited, bought £331 million of the UKT 8.75% 2017 (the 'Bond'), a UK government gilt. Committed in September 2011
37/1	*I C Hannam* 27 February 2012 [2014] UKUT 0233 (TC) Appeal number FS/2012/0013 Final Notice on 17 July 2014 ICH01012	£450,000	Hannam engaged in two instances of market abuse by disclosing inside information other than in the proper course of his employment in two emails dated 9 September and 8 October 2008
38/1	*K G Carver* 30 March 2015 **Profit**: £24,206	£ 35,212	Carver purchased 62,000 shares in Logica Plc on the basis of information provided by Wilmott (see in the Criminal cases table). Committed in May 2012
39/1	*W H Ireland Limited* (RN 140773) 22 February 2016	£1,200,000	WHI failed to take reasonable care to organise and control effective systems and controls to protect against the risk of market abuse occurring during the period 1 January to 19 June 2013
40/1	*M S Taylor* FCA reference number MST00007 5 May 2016 **Profit**: £3,498	£ 36,285	On 12 March 2015, Taylor bought 5,582 shares in Ashcourt Rowan Plc for $15,012. This purchase was based on inside information he received through an email circulated in error by his employer, Towry Limited. He bought the shares using funds from his self-invested pension whilst aware he had acted on insider information. On the same day as his purchase, Towry subsequently made a public announcement of its intention to acquire Ashcourt with a revised offer. This announcement resulted in the share price of Ashcourt rising by 26%. The initial amount of penalty set by the FCA

			of £78,819 was reduced as a result of a verifiable evidence that he was experiencing financial hardship
41/1	*G D P Breeze* 15 July 2016	£59,557	Attempted to sell his entire shareholding of 1,273,500 shares at the time when he held inside information on 18 and 19 September 2014. He was ordered to pay restitution in the amount of £1,850 plus interest of £259, which was passed on by the FCA to the persons who have suffered loss. Also the FCA imposed a public censure on him
42/1	*Tejoori Limited* 13 December 2017	£100,000	Tejoori Limited failed to inform the public as soon as possible of inside information which directly concerned it. <u>Committed in early 2016</u>
	Interactive Brokers (UK) Ltd 208159 25 January 2018	£1,049,412	Failed to take reasonable care to organise and control its affairs responsibly in relation to the detection and reporting of potential instances of market abuse from <u>6 February 2014 to 28 February 2018</u>
43/1	*C Gent* 5 August 2022	£80,000	He was Chairman of Convatec Group Plc. On 18 October 2018, he disclosed inside information.
44/1	*Citigroup Global Markets Ltd* 123384 19 August 2022	£17,934,030	During the period between <u>2 November 2015 and 18 January 2018</u>, failed to conduct its business with due skill, care, and diligence
45/2	*S Tyson* SXT01527 4 October 2022 and Sigma Broking Ltd 4 October 2022	£67,900 £531,600	Between <u>1 December 2014 and 12 August 2016</u>, he was Director, Chief Executive, and Money Laundering Reporting at Sigma Broking Limited. He failed to take reasonable steps to ensure that Sigma had adequate systems and controls
46/1	*M C Kent* MCK01043 4 October 2022	£83,600	See above
47/1	*S J Tomlin* SJT01114 4 October 2022	£69,600	See above
48/1	*BGC Brokers LP* *GFI Securities Ltd* *GFI Brokers Ltd* 7 December 2022	£4,775,200	Failed to take reasonable care to organise their affairs responsibly and effectively with adequate risk management surveillance for the purposes of detecting insider dealing, market manipulation, or attempted insider dealing or market manipulation

APPENDIX C

Factors under DEPP 6.5C.2[G](12),(13) and (14)

Nature	Deliberate	Reckless
(a) The frequency of market abuse – if committed on multiple occasions it will be considered to be level 4 or level 5 factors in accordance with DEPP 6.5C.2[G](15)(c)	(a) The market abuse was intentional, in that the individual intended or foresaw that the likely or actual consequences of his actions would result in market abuse (b) The individual intended to benefit financially from the market abuse, either directly or indirectly (c) The individual knew that his actions were not in accordance with exchange rules, share dealing rules and/or the firm's internal procedures	(a) The individual appreciated there was a risk that his actions could result in market abuse and failed adequately to mitigate that risk
(b) Whether the individual abused a position of trust – to be considered levels 4 or 5 factors DEPP 6.5C.2[G](15)(d) (e) Whether the individual is an experienced industry professional (f) Whether the individual held a senior position with the firm (g) Whether the individual acted under duress	(d) The individual sought to conceal his misconduct (e) The individual committed the market abuse in such a way as to avoid or reduce the risk that the market abuse would be discovered (f) the individual was influences to commit the market abuse by the belief that it would be difficult to detect. (g) the individual's action were repeated	(b) the individual was aware there was a risk that his action could result in market abuse but failed to check if he was acting in accordance with internal procedures
(c) Whether the individual caused or encouraged other individuals to commit market abuse	(h) for market abuse falling within the prohibition in art. 14(a) UK MAR, the individual knew or recognised that the information on which the dealing was based was inside information	

Appendix D

Shapiro-Wilk test of normality

Variable	Group	Kolmogorov-Smirnov			Shapiro-Wilk		
		Group	statistic	df	Group	statistic	df
lg10average_price_dif	0<29,000	.217	11	.156	.887	11	.127
	30,000<80,000	.126	9	.200*	.926	9	.448
	80,000 <	.122	11	.200*	.981	11	.971
log_average_price_dif	0<29,000	.217	11	.156	.887	11	.127
	30,000<80,000	.126	9	.200*	.926	9	.448
	80,000 <	.122	11	.200*	.981	11	.971

* This is a lower bound of the true significance

a. Lilliefors Significance Correction

APPENDIX E

Post-hoc comparisons tests

Multiple Comparisons

Dependent Variable		(I) Group2	(J) Group2	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval Lower Bound	95% Confidence Interval Upper Bound
log10price_dif	Tukey HSD	0<29,000	30,000<80,000	-.35790	.36872	.601	-1.2702	.5544
			80,000<	-.87901*	.34980	.046	-1.7445	-.0135
		30,000<80,000	0<29,000	.35790	.36872	.601	-.5544	1.2702
			80,000<	-.52111	.36872	.348	-1.4335	.3912
		80,000<	0<29,000	.87901*	.34980	**.046**	.0135	1.7445
			30,000<80,000	.52111	.36872	.348	-.3912	1.4335
	Bonferroni	0<29,000	30,000<80,000	-.35790	.36872	1.000	-1.2968	.5810
			80,000<	-.87901	.34980	.054	-1.7698	.0117
		30,000<80,000	0<29,000	.35790	.36872	1.000	-.5810	1.2968
			80,000<	-.52111	.36872	.506	-1.4600	.4178
		80,000<	0<29,000	.87901	.34980	.054	-.0117	1.7698
			30,000<80,000	.52111	.36872	.506	-.4178	1.4600
log10mean_shares	Tukey HSD	0<29,000	30,000<80,000	-.72190	.38640	.167	-1.6780	.2342
			80,000<	-.65837	.36657	.189	-1.5654	.2487
		30,000<80,000	0<29,000	.72190	.38640	.167	-.2342	1.6780
			80,000<	.06353	.38640	.985	-.8926	1.0196
		80,000<	0<29,000	.65837	.36657	.189	-.2487	1.5654
			30,000<80,000	-.06353	.38640	.985	-1.0196	.8926
	Bonferroni	0<29,000	30,000<80,000	-.72190	.38640	.217	-1.7058	.2621
			80,000<	-.65837	.36657	.250	-1.5918	.2751
		30,000<80,000	0<29,000	.72190	.38640	.217	-.2621	1.7058
			80,000<	.06353	.38640	1.000	-.9204	1.0475
		80,000<	0<29,000	.65837	.36657	.250	-.2751	1.5918
			30,000<80,000	-.06353	.38640	1.000	-1.0475	.9204

*. The mean difference is significant at the 0.05 level.

APPENDIX F

Descriptive statistics

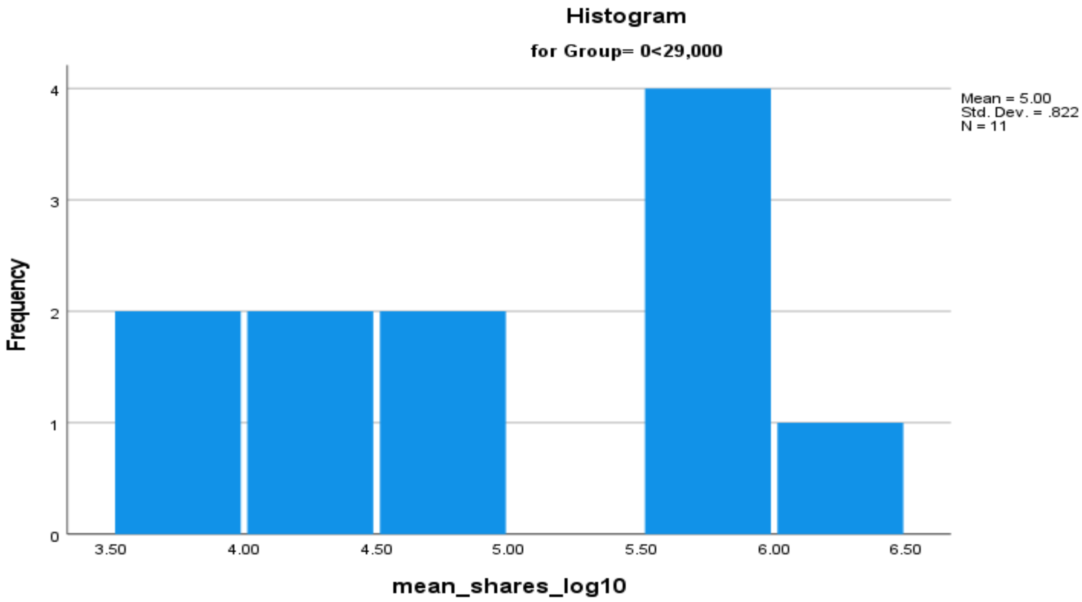
Descriptives

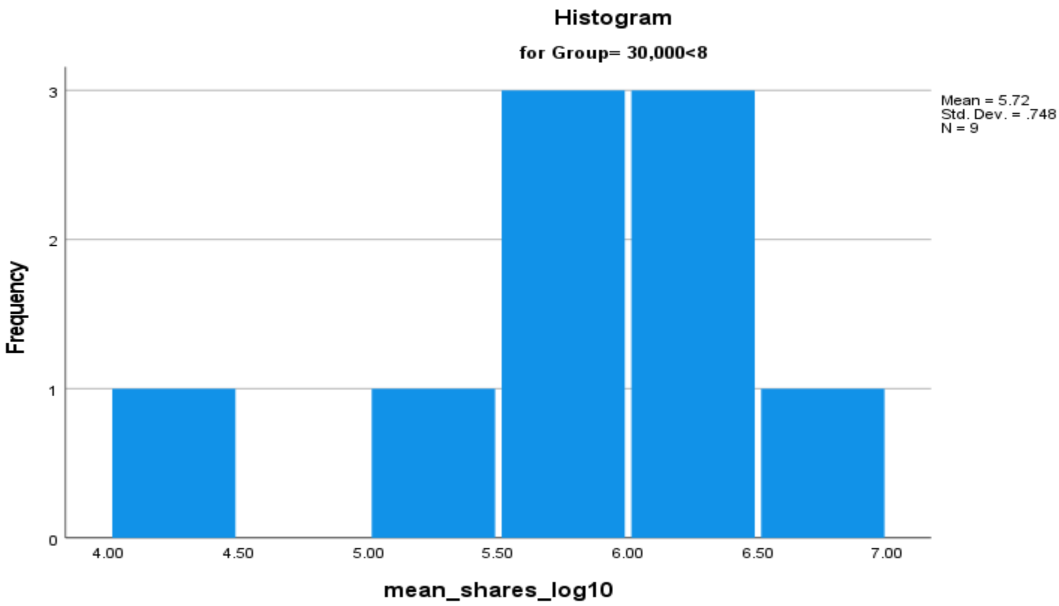
Group				Statistic	Std. Error
mean_shares_log10	0<29,000	Mean		4.9999	.24786
		95% Confidence Interval for Mean	Lower Bound	4.4477	
			Upper Bound	5.5522	
		5% Trimmed Mean		4.9990	
		Median		4.8451	
		Variance		.676	
		Std. Deviation		.82206	
		Minimum		3.90	
		Maximum		6.11	
		Range		2.21	
		Interquartile Range		1.67	
		Skewness		-.094	.661
		Kurtosis		-1.608	1.279
	30,000<8	Mean		5.7218	.24936
		95% Confidence Interval for Mean	Lower Bound	5.1468	
			Upper Bound	6.2969	
		5% Trimmed Mean		5.7696	
		Median		5.9143	
		Variance		.560	
		Std. Deviation		.74809	
		Minimum		4.05	
		Maximum		6.54	
		Range		2.49	
		Interquartile Range		.82	
		Skewness		-1.589	.717
		Kurtosis		2.776	1.400
	80,000<	Mean		5.6583	.29324
		95% Confidence Interval for Mean	Lower Bound	5.0049	
			Upper Bound	6.3117	
		5% Trimmed Mean		5.6511	
		Median		5.6435	
		Variance		.946	
		Std. Deviation		.97255	
		Minimum		4.38	

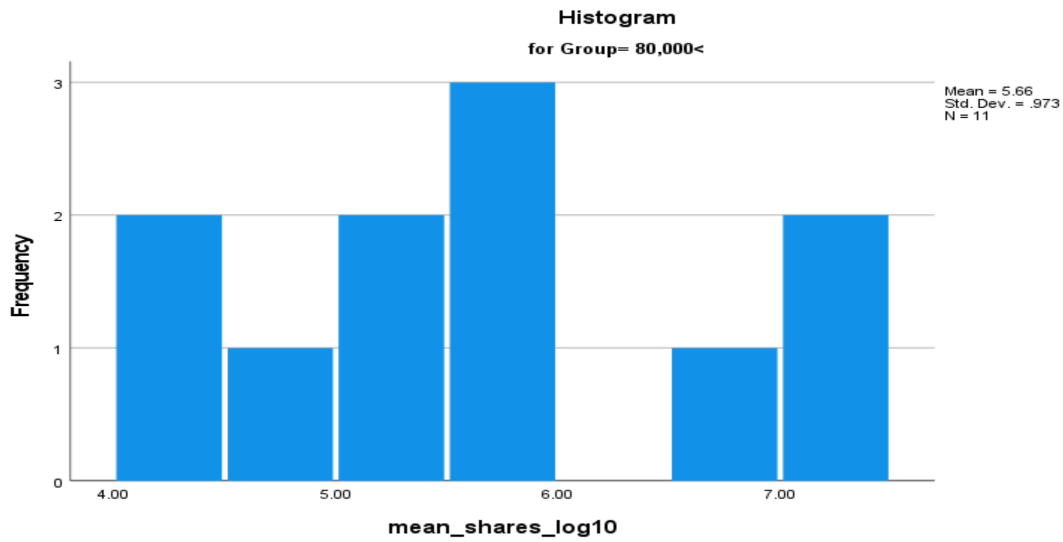
	Maximum	7.07	
	Range	2.69	
	Interquartile Range	1.92	
	Skewness	.266	.661
	Kurtosis	-1.186	1.279

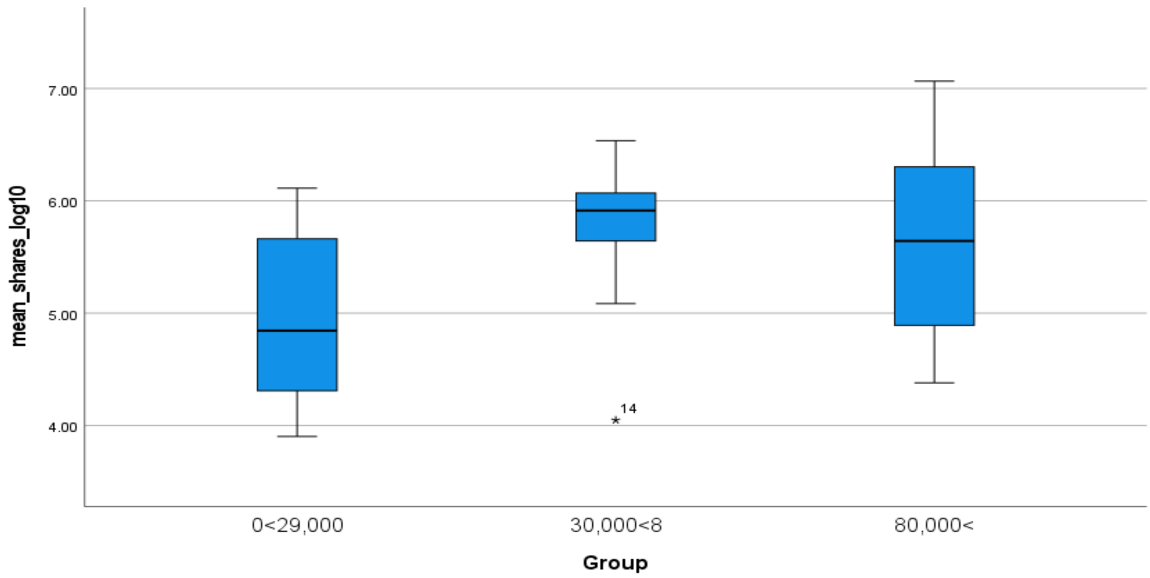
APPENDIX G

Histograms and boxplot for log10 mean_shares



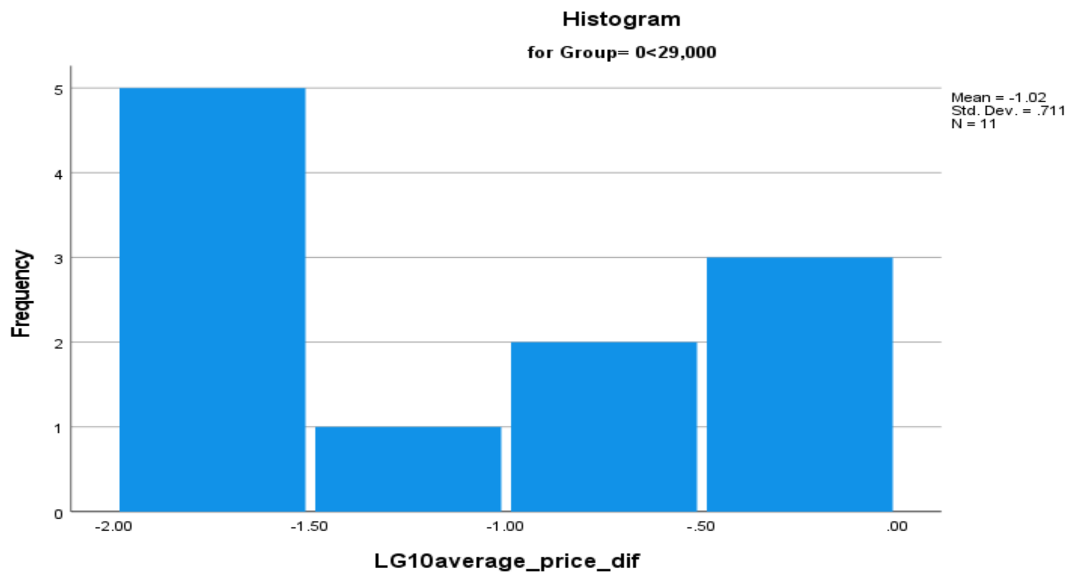


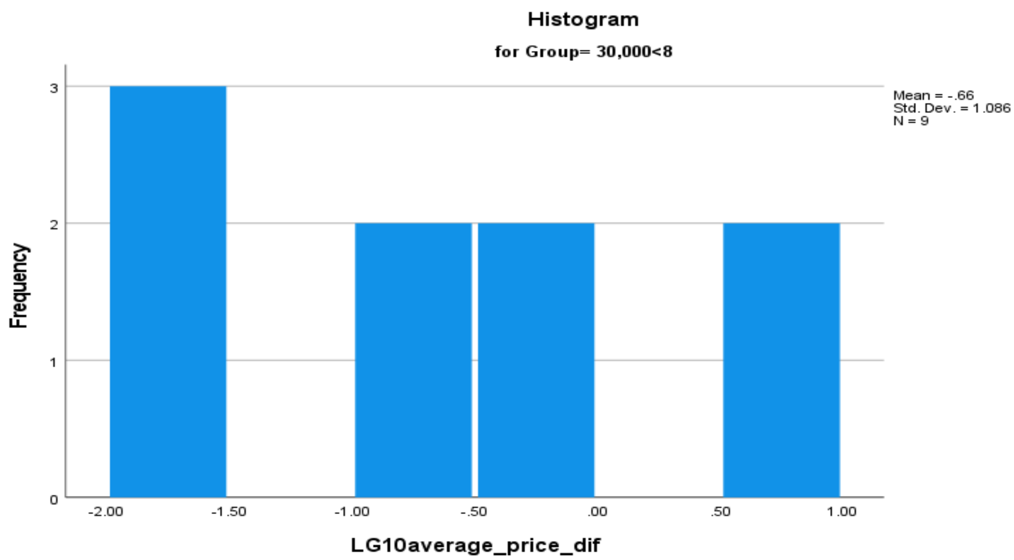

Histogram
for Group= 80,000<
Mean = 5.66
Std. Dev. = .973
N = 11
Frequency
3
2
1
0
4.00
5.00
6.00
7.00
mean_shares_log10

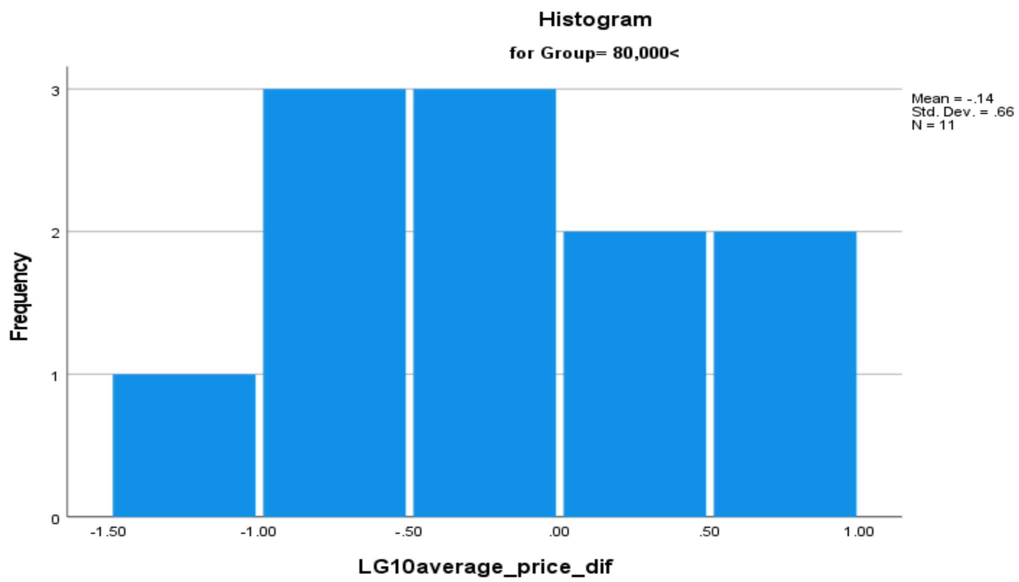

mean_shares_log10
7.00
6.00
5.00
4.00
14
0<29,000
30,000<8
80,000<
Group

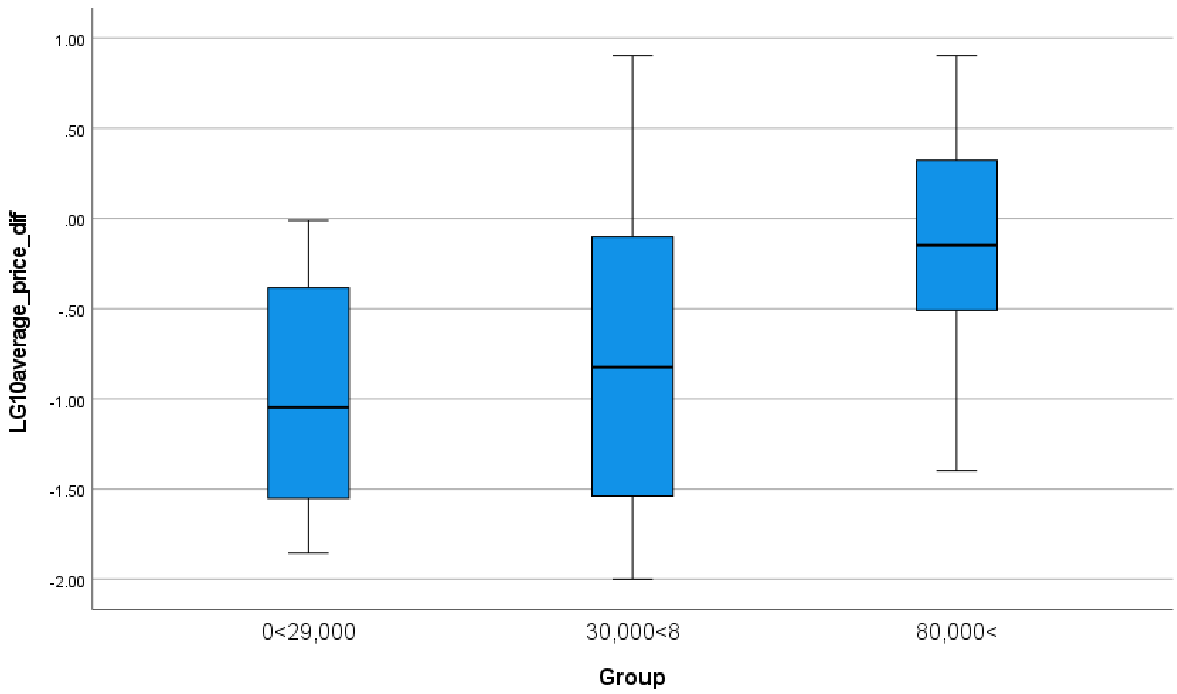
APPENDIX H

Histograms and boxplot for log10 price_diff






Histogram
for Group= 80,000<
Mean = -.14
Std. Dev. = .66
N = 11
Frequency
3
2
1
0
-1.50
-1.00
-.50
.00
.50
1.00
LG10average_price_dif


LG10average_price_dif
1.00
.50
.00
-.50
-1.00
-1.50
-2.00
0<29,000
30,000<8
80,000<
Group

List of abbreviations

FCA: Financial Conduct Authority

FSA: Financial Services Authority

CJA 1993: Criminal Justice Act 1993

UK MAR: United Kingdom Market Abuse Regulation

FSMA 2000: Financial Services and Markets Act 2000

DEPP: Decision Procedure and Penalties Manual

EG: Enforcement Guide

DTR: Disclosure Transparency Requirements

SYSC: Senior Management Arrangements, Systems and Controls Sourcebook

SUP: Supervision

COCON: Code of Conduct

PRIN: Principles for Businesses

STOR: Suspicious Transaction and Order Report

PDMR: Persons Discharging Managerial Responsibilities

RTS: Regulatory Technical Standards

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David Massey v. Financial Services Authority [2011] Upper Tribunal (Tax and Chancery Chamber) UKUT 49 (TCC) 2 February 2011

Dawson International plc v Coats Patons plc [1989] BCLC 233

Fleurose v The Securities and Futures Authority Ltd [2001] EWCA Civ 2015

Gething v Kilner [1972] 1 W.L.R. 337

Great Eastern Railway Company v Turner (1872) L.R. 8 Ch. 149

Hannam v FCA [2014] UKUT 0233 (TCC)

Hornal v Neuberger Products Ltd [1956] 3 All ER 970

Ian Charles Hannam v FCA, [2014] UKUT 0233 (TCC) 27 May 2014

Massey v FSA [2011] UKUT 49 (TCC) UPTC FIN/2009/0024

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Regulation (EU) 2016/957 of 9 March 2016 supplementing Regulation 596/2014 with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions

Regulation (EU) 2016/347 of 10 March 2016 laying down implementing technical standards with regard to the precise format of insider lists and for updating insider lists in accordance with Regulation 596/2014

Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

Regulation (EU) 2016/960 of 17 May 2016 supplementing Regulation (EU) 596/2014 with regard to regulatory technical standards for the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings

Regulation (EU) 2017/571 of 2 June 2016 supplementing Directive 2014/65/EU with regard to regulatory technical standards on the authorisation, organisational requirements and the publication of transactions for data reporting services providers

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Regulation (EU) 2017/589 of 19 July 2016 supplementing Directive 2014/65/EU with regard to regulatory technical standards specifying the organisational requirements of investment firms engaged in algorithmic trading

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Principles for Businesses (PRIN)

Senior Management Arrangements, Systems and Controls (SYSC)

Code of Conduct (COCON)

Fit and Proper test for Employees and Senior Personnel (FIT)

Conduct of Business Sourcebook (COBS)

Client Assets (CASS)

Market Abuse (MAR)

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