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Compliance Monitor

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Renewed broom

*2008 was a busy year for FSA Enforcement, writes **Toby Robinson** of Travers Smith. Hector Sants, CEO of the FSA, set the tone in the Business Plan for 2008/9: "Our priority, in an enforcement strategy is to achieve credible deterrence… to achieve credible deterrence, wrongdoers must not only realise that they face a real and tangible risk of being held to account, but must expect a significant penalty."*

This year is likely to be no less busy. In his Overview to the 2009/10 Business Plan, Sants stressed the importance of having a "strong and visible enforcement function", predicting "significant enforcement activity in the coming year", with a particular focus on significant influence function (SIF) holders. The regulator is off to a strong start with its first successful criminal insider dealing prosecution at the end of March when the former general counsel of TTP Communications was convicted for leaking information about a takeover by Motorola to his father in law, who was found guilty of trading on it. Both received eight-month custodial sentences although the father in law's term is suspended for 12 months.

This article looks at some of the FSA's principal areas of focus in the last six months or so and examines some recent additions to the regulator's enforcement armoury.

Market misconduct

Civil action

Unsurprisingly, abuse has been at the forefront of FSA enforcement activity in the last six months or so. There were no market abuse Final Notices in the period March 2007 to June 2008. Since then we have had the important cases of John Shevlin (July 2008) and Steven Harrison (September 2008), followed by a rash of Final Notices in the period October 2008 to February 2009. Furthermore, the Tribunal's judgment in relation to Winterflood Securities' referral of the FSA's decision to impose a £4 million fine for market abuse confirms that market abuse can be committed even when "no actuating purpose or any mental element" has been proved. The applicants are seeking permission to appeal the decision at the Court of Appeal. [1]

Some of the recent Final Notices merit particular discussion. The first was that in respect of Darwin Clifton and Byron Holdings Ltd ('Byron'). Mr Clifton directed Byron to purchase shares in a company on four separate occasions during the relevant period. Byron had inside information relating to a particular agreement as a result of Mr Clifton's knowledge of it (although the other directors of Byron were not aware of the inside information). Byron's purchases of the shares based on that inside information therefore constituted insider dealing in breach of *section 118(2)* of the *Financial Services and Markets Act 2000* (FSMA). By directing Byron to purchase the shares, Mr Clifton took action to require Byron to engage in behaviour which, if engaged in by Mr Clifton, would have amounted to market abuse. The FSA therefore imposed a financial penalty upon Mr Clifton (£59,500) and Byron (£86,030 – representing disgorgement of profits) under *section 123(1)* of FSMA.

Another recent civil action was brought against Erik Boyen, he was fined £176,254 for dealing in the shares of Monterrico Metals plc ('Monterrico') on the basis of inside information. This case is interesting, primarily for its links to the November 2008 Final Notices involving Richard Ralph, the former British ambassador to Peru and ex-Chairman of Monterrico, an AIM-listed company, and his friend, Filip Boyen. On the basis of the matters set out in the Final Notice for Ralph, it is strongly arguable that this was a case ideally suited for a criminal prosecution for insider dealing. Ralph not only dealt himself on the basis of inside information (making a profit in the process) contrary to *section 118(2)* of FSMA, he also improperly disclosed inside information to Filip Boyen (who was fined just under £82,000), contrary to *section 118(3)* of FSMA. Ralph was fined approximately £118,000 (of which £12,600 represented disgorgement of profits). The FSA said that Ralph could have faced criminal proceedings had he not cooperated by approaching the FSA in the first place,

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admitting liability and agreeing to settle at an early stage. However, Ralph only contacted the FSA some nine months after the "covert share purchase", in circumstances where he knew that the FSA was making enquiries into suspicious trading prior to the takeover of Monterrico. Furthermore, it would appear that the evidence against Ralph could not have been stronger. His "admissions" are to be viewed in this light.

So why weren't Ralph and Filip Boyen prosecuted? The answer may be that they gave rather more cooperation than the FSA let on, one view being that they were afforded leniency (as to which, see below) in return for assisting the FSA in the case against Filip's brother, Erik.

Criminal action

A central plank of the FSA's "credible deterrence" strategy is the determination to use its criminal enforcement powers more regularly. To this end, the Business Plan for 2009/10 states that significant sums have been earmarked for legal fees in relation to the increasing number of criminal insider dealing proceedings that are on foot, including the recently announced prosecution of Neil Rollins. Furthermore, David Kirk has recently been appointed as FSA's Chief Criminal Counsel. This follows the regulator's relatively recent recruitment of a number of criminal specialists (including lawyers and investigators). It all represents a significant change in the FSA's approach, the perception having previously been that the FSA is reluctant to bring criminal proceedings in light of the stringent two-fold test to be met under the Code for Crown Prosecutors, the higher burden of proof and historical problems with getting a jury to convict. Notwithstanding the hurdles in its way (it accepts that not all such prosecutions will succeed), the FSA has made it clear that more criminal insider dealing proceedings can be expected

Leniency is an important tool recently added to the FSA's armoury (December 2008). Chapter 12 of the Enforcement Guide now contains leniency provisions for a person who has engaged in market abuse in concert with another person, being behaviour which the FSA believes to be a powerful factor in favour of criminal prosecution, but who comes forward, provides information and assists fully in the prosecution of the other person. In those circumstances, the FSA will take such cooperation into account when deciding whether to prosecute or to bring regulatory proceedings against the individual. The FSA has stressed that a whistleblower cannot be offered a guarantee that he or she will not be prosecuted – the evidential and public interest tests under the Code for Crown Prosecutors will still need to be considered. If it is right that Ralph and Filip Boyen escaped prosecution in return for assisting the FSA vis-à-vis Erik Boyen, then one might have expected the latter to have been prosecuted.

It remains to be seen whether leniency will, in the long run, assist the FSA in its quest to bring more criminal insider dealing prosecutions. Will miscreants turn themselves in in circumstances where there can be no guarantee that they will not be prosecuted either by the FSA or, even if the FSA agrees not to prosecute, other prosecuting authorities such as the Serious Fraud Office? Furthermore, the FSA has stated that those to whom leniency is extended can still expect to face market abuse proceedings.

This leads on to the imminent inclusion of the FSA on the list of bodies that can grant individuals immunity from prosecution under the *Serious Organised Crime and Police Act 2005*. Unlike leniency, which, if granted by the FSA, would not prevent another body from instituting criminal proceedings, an individual served with an immunity notice would have complete protection from prosecution. The FSA has for some time now been crying out for this power, which it firmly believes will act as a deterrent to wrongdoers on the grounds that potential market abusers will realise that they are more likely to get found out. Again, time will tell if this new power has the desired effect.

Breaches of the Disclosure and Transparency Rules (DTRs) and the Listing Rules

Linked to the market abuse regime is the obligation on listed companies to notify the market as soon as possible of any inside information concerning an issuer (DTR 2.2.1) and to communicate information to holders of actual / potential holders of securities in such a way as to avoid the creation or continuation of a false market (Listing Principle 4). This is something that has recently re-surfaced as an important issue and listed companies are likely to have to grapple with the dilemmas these rules pose over the coming year in the light of the ongoing global turmoil in the markets. It seems highly likely that listed companies will be faced with more and more bad news involving, for example, variations and/or terminations of contracts leading to reduced profits.

The Final Notices in respect of Entertainment Rights plc (fined £245,000) and Wolfson Microelectronics plc

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(fined £140,000), published on the same day (19 January 2009), echo the Woolworths Group plc Final Notice published in June 2008. The key points arising from these cases are as follows:

- bad news cannot be offset against good news (or potential good news). Both should be disclosed, leaving the market to determine whether they cancel each other out;
- issuers should take timely professional advice from lawyers or corporate brokers – not from investor relations advisers;
- appropriate internal processes enabling issuers to identify in a timely fashion whether or not information is inside are essential; and
- announcements should not be delayed just because the issuer is unable to quantify precisely the impact of bad news.

Focus on senior management

Senior management are increasingly finding themselves in the firing line. For example, the CEO of Land of Leather was fined £14,000 for his failure to ensure that adequate systems and controls were in place in relation to the sale of Payment Protection Insurance (PPI). The case of Michael Wheelhouse is significant in that he was the first MLRO to be fined by the FSA. In October 2008, he was fined £17,500 for breach of Principle 7 of the FSA's Principles for Approved Persons for failing to ensure that adequate anti-money laundering controls for verifying and recording clients' identities were in place at his employer, Sindicatum Holdings Limited. More recently, a prohibition order and an £80,000 penalty were imposed on Stephen Griggs arising out of his failings as a director and the chief executive of a retail stockbroker, Pacific Continental Securities UK Limited ('PCS', which was itself publicly censured). Griggs was found to have failed both to have acted with integrity and to have taken reasonable steps to ensure that the business of PCS for which he was responsible was organised so that it could be controlled effectively, leading to high risk shares being mis-sold to customers.

Systems and controls failures

There have been some important cases relating to systems and controls failures. For example, Credit Suisse was fined £5.6m for failing to have systems in place to prevent (in some cases deliberate) mispricing of asset-backed securities and, more recently, Aon was fined £5.25m in relation to inadequate systems and controls leading to potential (and in some cases, actual) corrupt practices abroad going undetected.

Retail

On the retail side, there has also been a plethora of high risk shares and mortgage mis-selling cases, various data security loss cases, as well as old chestnuts such as PPI and Treating Customers Fairly. More of these can be expected to follow in the coming months.

Conclusion

The FSA, having been subjected to a barrage of criticism in the wake of its supervisory failings over the last 18 months and its unwillingness to use its criminal powers to prosecute insider dealing, will continue to flex its enforcement muscles in the coming months – "credible deterrence" is here to stay. As if the message wasn't clear enough, Hector Sants recently declared that "[p]eople should be very frightened of the FSA." Those firms and individuals who, in these difficult times, try to cut corners or engage in behaviour that they would not ordinarily engage in in order to recoup financial losses or gain an advantage over their competitors, have been warned!

Notes

1 The Winterflood decision was announced just as *CM* was going to press.

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