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INSIDERS, OUTSIDERS, ROGUES AND SOPHISTICATES

Lessons in Business Protection from the Coal Face
Market Abuse and Investor Losses

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FSA Enforcement 2012

- Credible Deterrence
  - Individuals/Senior Management
  - Higher Fines
  - Criminal Prosecutions

Novel Approaches

- Injunctions/Civil Court Actions
  - Samuel Kahn
  - Barnett Alexander
  - Da Vinci
- Publicity
- Product Intervention
  - TPLIs, Sale and rent back

Market Abuse- Insider dealing

- An insider
- deals or attempts to deal

  [in a qualifying or related investment]
- on the basis of
- inside information

Inside Information

- Relates to one or more issuers /investments and is
- Precise
  - Indicates circumstances/event that exist/has occurred or may reasonably be expected to; and
  - Specific enough to form a conclusion as to the possible effect on the price; and
- Not generally available; and
- Likely to have a significant effect on the price
  - If and only if…of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions

No Penalty – s123(2) FSMA

- FSA may not impose a penalty for market abuse on a person if there are reasonable grounds for it to be satisfied that:
  - (a) he believed, on reasonable grounds, that his behaviour [was not market abuse]; or
  - (b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way [that was market abuse].

Background - Punch Taverns plc

- Buying for a year
- Held 13.3%
- Not sold any
- Results April 2009/Road show May 2009
  - No company mention of an equity issuance
  - Several shareholders/potential investors suggested it
- Convertible Bond/securitisation cash flow issues

Events

8 June 2009 - Wall crossing calls

9 June 2009 - The Punch Call

Immediate instructions to sell holding

10/11/12 June 2009 - About 1/3 holding sold

15 June 2009 - Punch announces equity issue

Share price falls 29.9%

Greenlight avoided loss of £5.8million

The Punch Call 9 June 2009

Punch management/Punch broker/David Einhorn/Greenlight analyst

- About 45 minutes
- Mainly about the merits of equity issue/risks of not issuing
- Management “disclaimers” – conceptual, considering options, no decisions
- No-one shows concern inside information being discussed

FSA Finding

DE/Greenlight was informed on the Punch Call

- The amount of any equity issue – about £350million (against a market cap of about £400million)
- The purpose was to repay the convertible bond and create headroom in the securitisations
- The issuance was at an advanced stage ("imminent"); and
- was likely to proceed

FSA Finding

That was inside information

- Not generally available
- Event reasonably expected to occur (despite Punch's comments to the contrary)
- Clear interpretation of what was said disclosed the inside information (even if DE did not so interpret)
- Objective test. Duty to consider
- Specific – enough for a conclusion that the price would fall
- Of a kind which a reasonable investor would use

Thus DE and Greenlight committed market abuse insider dealing (and no s123 relief)

The Sell Order Call 9 June 2009

Alexander Ten-Holter, Greenlight UK execution trader and compliance officer/Greenlight

- Sell all Punch shares
- Just spoken to Punch management
- If Greenlight signed an NDA management would tell it “secret bad things”
- Other shareholders had signed the NDA and in Greenlight’s opinion would wish to sell
- About a week before the stock “plummets”, although that “might be a lie”

Further call with selling trader after announcement

FSA Finding

- Warning signs
- Should have investigated further the reasons for the sale before proceeding
- Should have investigated further after the announcement (accepted by AT-H)
    - Check in particular whether any advance information had been passed on the Punch Call
- Criticised assumption that risk was very low because of firm's strict policies on market abuse and high standards

FSA Finding

- AT-H breached APER Statement of Principle 6 – SIF due skill, care and diligence
- So did the selling trader, Caspar Agnew. Statement of Principle 2 CF due skill, care and diligence
    - Failure to raise a suspicious transaction report after announcement

- Andrew Osborne, Punch's Broker, committed market abuse improper disclosure

Penalties

Publicly accepted not deliberate or reckless

Did not know or believe the Punch Call transferred inside information

- DE - £3million fine, £638,000 disgorgement of loss avoided on his holdings in the funds
- Greenlight - £3million fine, £650,795 disgorgement of reduced performance and management fees avoided
- AT-H – Prohibition from Compliance oversight CF10 and Money laundering reporting CF11, £130,000 fine
- CA - £65,000 fine
- AO - £350,00 fine

Issues

- Not deliberate or reckless. No intention.
- Did not believe inside
- Can't rely on others
- Management/broker call after refusing to be wall-crossed – "unusual". Itself a red flag
- No reference to compliance/legal before sale

  "information…that makes you want to trade…"
- Also no reference to Punch
- AO did not consult legal before the Punch call (though Punch had)

Takeaways

- Market abuse/insider dealing training
- Non-wall crossing not enough – a red flag in itself.

But still make clear!

- Honest belief not enough even for market abuse
- Further investigation - records
- Be alert for STRs retrospectively
- D&O Insurance

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Individual fines 2011-12

- Largest fines:
  - £4m - Rameshkumar Goenka (17 October 2011)
  - £3.638m – David Einhorn (15 February 2012)
  - £2m – Michiel Visser (20 September 2011)
  - £1.367m - Ravi Sinha (31 January 2012)

- The largest fines tend to relate to market abuse and/or fraud, rather than failure to comply with legislation/regulations

- Approx. 15% of all fines in 2011 came from individuals

Compliance Officers

- Compliance officer roles – largest fines:
  - £130,000 – Alexander Ten-Holder (Greenlight Capital) – 26 January 2012
  - £90,000 – Timothy Pattison (Pave Financial Management) – 2 March 2011 (Decision Notice)
  - £49,000 – Julian Harris – 4 November 2011
- Average fine normally around £20,000 (before any deductions) – although depends on nature of offence
- FSA tends to go after relevant business as well – where it still exists
- Directors and officers insurance? Issues?

Serious Financial Hardship

FSA should consider whether reduction in penalty is appropriate if the penalty would cause the subject "serious financial hardship"

FSA will only consider reduction of penalty if:

- verifiable evidence of hardship is provided; and
- this evidence is disclosed in a full, frank and timely manner, and the individual co-operates with FSA's questioning about financial position

Serious Financial Hardship

For individuals, starting point is that individual will only suffer serious financial hardship if, over a reasonable period (usually no greater than three years):

- net income will fall below £14,000
- capital will fall below £16,000

as a result of payment of the penalty (DEPP 6.5D.2G)

Common for fines of £20,000 or less to be forfeited where SFH is successfully demonstrated

- experience suggests this line is hardening

Settlement Discount Scheme

In appropriate cases the FSA may negotiate the level of the financial penalty. A discount will then be applied, depending on the stage that agreement is reached:

- Stage 1 – 30%
- Stage 2 – 20%
- Stage 3 – 10%

Approximately ¼ of cases in 2011/12 have qualified for Stage 1 or 2 discount

Other sanctions

FSA can also impose additional sanctions – these can include:

- Prohibition order on performing any function in relation to an regulated activity
- Prohibition order on performing CF10 or any other compliance oversight or influence controlled function in relation to an regulated activity
- Withdrawal of approval to perform controlled function of CF10
- Public statement of misconduct

The growing co-operation between supervision and enforcement

Arrow Visits

Areas of interest include:

- Financial crime
- Secret commissions
- Relationship between agent and client
- Bribery and corruption
- Relationships with customers

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SOPHISTICATE CASES

- Wilson and Another -v- MF Global
- Casa di Risparmio della Republica di San Mario Spt -v- Barclays Bank
- Titan Steel Wheels Ltd -v- RBS
- Springwell Navigation Corporation -v- JP Morgan Chase Bank and Others

SOPHISTICATES

- Camerata Property Inc -v- Credit Suisse Securities (Europe) Ltd
- Zaki and Others -v- Credit Suisse (UK) Limited
- Bank Leumi (UK) plc -v- Wachner
- Winnetka Trading Corporation -v- Julius Baer International Limited

Wilson and Another -v- MF Global

Claims:

- FSMA s.150.
- Breach of express or implied contractual terms.
- Negligence.

Outcome:

- Claimant was correctly classified as an “intermediate customer” and account was properly “execution only”.
- No advisory relationship.
- No assumption of responsibility.
- Defendant could rely on exemption clauses in the account documentation.

Casa di Risparmio della Republica di San Mario Spt -v- Barclays Bank

Claims:

- Misrepresentation (fraudulent and negligent).
- Implied term in relation to advice.

Outcome:

- The Defendant was entitled to rely on the terms of the agreement and disclaimers and the Claimant was to be regarded as sophisticated and knowledgeable. No representation of fact was made as to risk.

Titan Steel Wheels Ltd -v- RBS

Claim:

- S.150 FSMA.

Outcome:

- The Claimant was an experienced currency trader and this was integral to its business, therefore, the Claimant was not a private person for the purposes of s.150. Further, the contract expressly provided that no advice was being given and there was, therefore, no duty of care in relation to the Defendants recommendations, suggestions or advice.

Springwell Navigation Corporation -v- JP Morgan Chase Bank and Others

The Claimant was the bank and Defendant the private individual. The Claimant issued proceedings for non-liability. The Defendant counter-claimed alleging:

- Breach of contract.
- Negligence.
- Breach of fiduciary duty.
- Negligent misstatement and/or misrepresentation.

Springwell - Cont.

Outcome:

- There was no duty of care as there was no advisory relationship. The Defendant was estopped from relying on misrepresentations in any case as it had been agreed by contract that the Claimant did not accept responsibility for statements made by its staff (upholding Peekay).
- The Court of Appeal further found that there were no misrepresentations and that statements should be taken in their context.
- Even had misrepresentations been made, they would not have been actionable as they were not factual misrepresentations, nor was there any negligent misstatement.

Camerata Property Inc -v- Credit Suisse Securities (Europe) Ltd

Claim:

- Negligence.

Outcome:

- Claimant was a wealthy businessman in "relatively adventurous investments which involved a risk of loss". The Defendant had not been negligent in its advice and, even if it had been, there was no evidence of loss by the Claimant.

Zaki and Others -v- Credit Suisse (UK) Ltd

Claim:

- Breach of statutory duty to comply with Conduct of Business Rules.

Outcome:

- No evidence of loss. Claimant relied on his own views so, even if the Defendant had not taken all reasonable steps to ensure that the products were suitable, there was no evidence that this would have made any difference.

Bank Leumi (UK) plc -v- Wachner

The Bank was the Claimant and the individual the Defendant. The Claimant was looking to enforce a series of margin calls and associated losses. The Defendant counterclaimed:

- Misrepresentation.
- Negligence.
- Improperly classified.

Bank Leumi - Cont.

Outcome:

- There was no actionable misrepresentation and even if there had been, the Defendant would have been contractually estopped from relying on them. The Claimant had taken reasonable steps to properly classify the Defendant's level of experience, and classifying her as an intermediate customer was appropriate in the circumstances.

Winnetka Trading Corporation -v- Julius Baer International Ltd

Claims:

- Failure to comply with instructions.
- Failure to advise of risks.

Outcome:

- The Defendant had complied with the contractual duties, including those in the alleged implied term. The Claimant was a sophisticated investor and there was no evidence that it had even sought advice, let alone would have relied on such advice. Further, the FSA's rule to inform the client of the scope of the duty of care does not extend to warning of the riskiness of express instructions.

Developing Trends : 8-0 to the Defendants

Claims which have been brought include:

- FSMA s.150
- Negligent advice
- Misrepresentation
- Negligent misstatement
- Breach of contract (implied or express term)
- Breach of statutory duty
- Fraud

Developing Trends – Cont.

The Court is essentially asking two questions in all these cases:

- Was the Defendant a seller or an advisor?
- How sophisticated is the Claimant?

Developing Trends – Cont.

- Prospective Defendants to negligent mis-selling, misrepresentation and other financial services claims should be encouraged by the trends in the case law.
- Where a party is an experienced or sophisticated investor, they will find it very difficult to bring a claim for negligence or misrepresentation or any similar such claim.
- The Court will be reluctant to find an advisory relationship, particularly where a contract says there is none, and simply providing information as to the market and the products available will not elevate an executionary relationship to an advisory one.

How to Avoid Investor Claims

- Make the non-advisory relationship clear in the contractual documentation.
- Make the non-advisory relationship clear in any market or product information provided.
- State in contract that no representations have been made or relied upon or have similar exclusions/disclaimers.
- Stay within the terms of the contract.

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