News flash

ROBINSIMON

This is the first edition of the Newsflash, which is intended by Robin Simon LLP to be an occasional information sheet concentrating on a single topic relevant to the Insurance world. We hope that this and following editions may prove of interest to you and your colleagues. In due course we will be publishing a more compendious Newsletter with a range of insurance-related articles and information about Robin Simon LLP. Some of that information is already available on our website at **www.robinsimonllp.com** and in the attached Contact Card.

UK Insider Trading Investigations

The Financial Services Authority ('FSA') has certainly got its work cut out since N2. In the past the FSA have been criticised for lacking any real teeth to protect ordinary investors and maintain confidence in the financial services industry. Since the enactment of the Financial Services & Markets Act 2000 ('FSMA 2000'), the FSA has been empowered to investigate a range of financial services offered by the industry. Amongst the most recent and highly publicised; pensions mis-selling, endowments, splits, IPO laddering and spinning. The most recent area to come into the spotlight is the FSA probe into what appears to be a resurgence of insider trading.

Insider trading is certainly not new. During the 1980s it was a series of trading scandals. As such, insider dealing was made a criminal offence (Part V Criminal Justice Act 1993). The difficulty, however, has been in securing convictions as the level of proof required in a Criminal Court is 'beyond reasonable doubt'. Accordingly, the FSMA introduced the new civil offence of insider trading.

Between 1997 and 2000 there were just four prosecutions and two convictions for insider trading in the UK. This rose to fourteen prosecutions and ten convictions in 2001 and five prosecutions, two of which were successful in 2002. The best-known recent example is that of the former Financial Journalist and City Public Relations Consultant, Tim Blackstone, who was found guilty of insider trading in shares of Murray Financial Corporation. Mr Blackstone made £3,000 on the deal, which he was ordered to return and was fined an additional £1,000. However, the sum of money concerned is small and Mr Blackstone was not a City high flier. The test for the FSA, it is to be viewed as a force to be taken seriously, will be to concentrate on the big players illicitly making large sums of money.

US Perspective

We are led to believe that London is more vulnerable to insider trading than the US, which have a tough regulator in the form of the Securities Exchange Commission ('SEC'). However, this has not prevented a number of stock market and accounting scandals. It was not so long ago (mid-2002) that the US President, George Bush, was forced to defend his own corporate behaviour as a Texas oilman. Mr Bush had failed to file a form detailing the purchase in 1997 of US$850,000 of stock in Harken Energy Corporation, 2 months before the value of the company's shares plummeted. At the time, Mr Bush was a board member of the oil company, which was later the subject of an SEC investigation. President Bush has more recently promised to crack down on the corporate wrongdoers.

Lifestyle Guru, Martha Stewart, has also been subject to a lawsuit by an investor alleging that Ms Stewart sold shares in her own company, Martha Stewart Living Omnimedia, knowing she could be investigated on suspicion of insider trading in the ImClone case. Ms Stewart also faces another lawsuit from a shareholder who claims to have suffered losses of US$75,000 as a result of her involvement in the insider trading scandal. Executives at the US media giant AOL Time Warner have been accused of benefiting from insider trading amounting to $66bn.

Several former and current Executives at AOL, as well as their auditors Ernst & Young, have been named in the lawsuit filed in Los Angeles on 14 April 2003, concerning the sale of 35 million stock options valued at US$1.7b, for 5 of AOL's top executives.

Europe

On 20 December 2002 George Soros, a multi-billionaire investor, was found guilty of insider trading and ordered to pay £1.4m in fines by a French Court. The Court found that Soros used insider information to buy himself shares in the French company Société Générale in 1998. The level of the fine was intended to equal the profits that Soros made on the illegal trades.

Currently, there is ongoing the 4 month Elf Aquitaine trial in France, where the Chief Executive, Loik Le Floch-Prigent, and two others who ran the then state owned company in the 1990s, are accused of creaming off hundreds of millions of dollars of company money.

Beyond

In January 2003 Canadian Regulators, the Ontario Securities Commission, commenced proceedings against ATI Technology, its CEO and five other people alleging insider trading. It is alleged that they used insider trading to make nearly CAN$8m in profits and reaped tax benefits. A hearing is pending.

In Australia, the Insurer AMP faces an enquiry by Regulators into futures trading prior to suspension of the group's shares. The suspension came in the run up to an announcement of a rights issue and de-merger. Australia's Securities and Investments Commission has confirmed that the Regulator has launched preliminary enquiries into trading in futures, sparked by outrage in Australia where institutions were seen to have benefited from the knowledge of plans that were not available to nearly 1,000,000 small shareholders. The enquiry centres on the Australian Share Price Index Futures Contract. Trading volumes were said to double those of a typical days trading, which was very unusual movement in a short time.

Market Abuse Regime – Civil Offence

It is the responsibility of the FSA to pursue offenders under the market abuse powers contained in FSMA 2000 (Part VIII). Market abuse is behaviour, which occurs in relation to qualifying investments traded on a prescribed market, based upon relevant information, which is generally unavailable and creates a false or misleading impression, and/or behaviour, which distorts the market.

The new FSMA 2000 regime supplements, rather than replaces, the existing criminal provisions for insider dealing and market manipulation. This applies to persons, whether or not authorised, who require or encourage another to engage in behaviour, which would amount to market abuse i.e. using information which is not generally available publicly and creating a phoney and often over inflated impression as to the value and/or demand of the investment concerned. The FSA has the power to punish by way of unlimited fines, public censure, restitution and injunction.

The FSA Enquiry into Insider Trading

Pursuant to its new found strength, the FSA has launched its largest investigation into allegations of insider dealing involving 5 well known companies: supermarket chain Somerfield, mobile phone operator 02, contractor Amey, security firm Chubb and football website operator, Teamtalk. This follows unprecedented rises in share prices and large volumes of trading activity, preceding approach announcements to the market.

The FSA may be assisted by its greater flexibility in terms of enforcement powers, with power to take action against anyone who abuses the market. The burden of proof is much lower, i.e. on the balance of probabilities, rather than beyond a reasonable doubt, as in criminal prosecution.

There is some concern that this will affect private investors who log on to web sites and disperse information on a hunch that there maybe a merger or acquisition. Rumours or mis-information on a company from outside could result in individuals finding themselves before the FSA Tribunal, subject to an unlimited fine and ordered to pay compensation. To complicate matters, investors need not have the intention to mislead other investors by their actions in order to be found guilty of having committed market abuse. The real questions are whether the information is or is not publicly available, and whether investors have suffered a material loss from the statements or behaviour for a finding of market abuse. It is also sufficient that a regular user of the market was given a false or misleading impression of the supply/demand, price/value of the investment in question.

For now, the FSA investigations are still at very early stages, and it remains to be seen whether the FSA is successful and can utilise the new powers given to it. The FSA is yet to bring a prosecution, and this would require the conviction of a major player. The message to the FSA is to get tough with market abusers. It will be interesting to see the level of fines imposed by the FSA and how these are calculated.

D&O Market

Currently, most D&O policy wordings exclude fines imposed by Regulators under the definition of 'loss' and only provide for representation costs in defending the director or officer concerned. However, some policies extend the definition of 'loss' to include civil fines and penalties, and where the FSA initiates an investigation under its market abuse regime, any fines/penalties may be covered.

The fraud/dishonesty/personal benefit exclusion may also apply, although Insurers may want to require some amendment of the 'in fact' policy wording. Currently there is no definition of 'in fact'. This may also have a knock on effect on the 'Advancement of costs Clause', where there is a later finding of dishonesty or fraud. Insurers may require an undertaking from the Insured to repay advanced defence costs where a finding is actually made.

The Financial Institutions team at Robin Simon LLP comprises lawyers who have practical experience of FSA and SEC investigations and includes two who are dual qualified (US/UK). If you would like to have further information on this or related topics, please contact a member of the Financial Institutions team:

Nilam Sharma
T +44 (0)870 839 0804
E nilam.sharma@robinsimonllp.com

Misha Nateghi
T +44 (0)870 839 0806
E misha.nateghi@robinsimonllp.com

Simon Gildener
T +44 (0)870 839 0808
E simon.gildener@robinsimonllp.com

Nicola Blakemore
T +44 (0)870 839 0811
E nicola.blakemore@robinsimonllp.com

For information about Robin Simon LLP please contact:

David Simon
T +44 (0)870 839 0888
E david.simon@robinsimonllp.com

These brief articles and summaries should not be applied to any particular set of facts without seeking legal advice. © Robin Simon LLP 2003