FCA Reports Low Levels of Potential Insider Trading: The result of effective enforcement or the free hand of the market?

AUGUST 14, 2015

In its annual report published last month, the FCA found that suspicious trading in the run up to M&A deals being announced is at a historic low. It reports that its "market cleanliness" statistic for takeover announcements has declined from around 30% for the four years prior to 2009 to 13.88% in 2014. The FCA states that this statistic provides a simple indicator of the proportion of potential insider trading cases relative to the sum of all takeovers in a given period. However, is this statistic down because of effective enforcement, or is it simply because of unconducive market conditions?

Before addressing that question, and as the FCA duly note, the statistic does not provide a perfect level of insider trading, but the observed decline in the incidence of potential insider trading does suggest that it is becoming rarer. Insider trading in the UK is prohibited as part of the market abuse regime, which includes offences in relation to both insider dealing and market manipulation.

In terms of whether potential insider trading is down because of effective enforcement, the FCA is always keen to suggest that its tough enforcement action is helping to improve standards within the City—and it has had some successes recently that seem to support such an assertion. For example, across the financial markets as a whole, the FSA/FCA has secured 27 convictions for insider dealing since the beginning of 2009 which have resulted in prison sentences of up to 4 years. (Some of the sentences were suspended due to substantial cooperation or particular personal circumstances.)

This has been coupled with a strong "tone from the top" message that market abuse in all its guises will not be tolerated. The Fair and Effective Markets Review (FEMR) final report released in June 2015 by HM Treasury, the Bank of England, and the FCA aims to send out the message that "the age of irresponsibility is over" in the financial industry. To that end the FEMR final report made recommendations to raise standards, professionalism and accountability of individuals within the industry. Such recommendations include developing common standards for trading practices, new expectations for training and qualifications, improving the way financial firms give references to each other, extending the criminal sanctions for market abuse and increasing the maximum criminal sentence for market abuse offences from 7 to 10 years. Two notable FEMR recommendations are to extend the Senior Managers and Certifications Regimes, which are due to come into force on 7

March 2016, and to enhance surveillance of trading patterns and behaviour. Expanding the Senior Managers and Certification Regimes, which are designed to strengthen the ways in which senior managers can be held accountable for misconduct, to more financial institutions, such as brokers, could impact the culture and approach of management across wholesale markets. With insider trading difficult to identify and prosecute, it will be hoped that enhancing monitoring of trading patterns will assist the FCA to identify insider trading and to take appropriate action. The FCA has so far secured three convictions as part of its investigation into trading patterns, Operation Tabernula, and is prosecuting a further seven.

However, despite the recent FCA successes and strong rhetoric, many of the FEMR recommendations will be difficult and slow to implement. There is also a feeling that current low levels of potential insider trading may be a reflection of market conditions rather than effective enforcement action. For instance, the FCA note in their annual report that the market cleanliness statistic began to increase at the end of 2014. This coincided with a pickup in M&A activity, which has been at generally low levels since 2009. As such, whilst the low levels of potential insider trading recently reported and the enforcement successes should be encouraging, it is clear that the real test will come when the FEMR recommendations are implemented and market conditions improve. Only then will it be clear whether it is effective enforcement or the market that is primarily behind levels of insider trading.