Client Alert.

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FSA Steps Up UK Enforcement of Market Abuse: What "Should You" Know?

By Kevin Roberts and Duncan Grieve

On 25 January 2012 the UK Financial Services Authority (the **FSA**) sent a strong message to financial markets participants by fining hedge fund manager David Einhorn and his fund, Greenlight Capital (**Greenlight**), with a £7.2m fine for market abuse. Einhorn will personally pay £3.6m, the second-largest fine ever paid by an individual for this offence.

This FSA decision requires professionals in the financial services sector with access to inside information to take note. From Einhorn's statement criticising the actions of the FSA, and the reaction of the financial press it appears that there is a lack of awareness about the statutory test for market abuse. The test is not only, "***did they know***" (as Einhorn thought) but also "***should they know***".

Einhorn is a prominent New York-based hedge fund manager. In a 9 June 2009 conference call, a corporate broker acting for Punch Taverns plc (**Punch**) informed Einhorn that Punch was considering a £350m dilutive equity-raising. Over the next four days, following Einhorn's instructions, Greenlight disposed of 11.65m shares in Punch taking its stake from 13.3% to 8.89%. On 15 June 2009 Punch announced a £375m fundraising. The price of the Punch shares fell 29.9%. Greenlight's trading had prevented losses of approximately £5.8m.

The important point is that Einhorn had explicitly stated on the call that he did not want to be "wall crossed" (given confidential information that would prevent him trading). Under U.S. securities law, that request may well have protected him from prosecution for insider dealing. Not so in the UK. In their press release the FSA stated that they accepted that Einhorn's trading was not deliberate as he did not believe that he was party to inside information. Notwithstanding the former, by virtue of Einhorn's position and experience, the FSA stated, "*We expect someone in his position to be able to identify inside information when he receives it and act appropriately. His failure to do so is a serious breach of the expected standards of market conduct.*"

This decision is currently being heralded as a marked departure from prior FSA enforcement precedent but is in fact more subtle. Section 118 of the Financial Services and Markets Act 2000 (**FSMA**) sets subjective, as well as objective, standards that can be applied to individuals' actions in cases involving market manipulation[1] The FSA Handbook also specifies that the test is whether individuals "*know or should have known*" that they were dealing with inside information.[2] What is more novel is that the FSA were prepared to state that they accepted that Einhorn passed the subjective test (he was not aware that he was acting on inside information) but that he still failed the objective test (given his position and experience he should have known that he was acting on inside information).

The other key point to note is that specifying a wish not to be "wall crossed" and refusing to sign non-disclosure

[1] Section 118B of the Financial Services and Markets Act 2000 defines an "Insider" as "*any person who has inside information. . . (e) which he has obtained by other means and which he knows, or could reasonably be expected to know, is inside information*".
[2] MAR 1.2.8 - https://fsahandbook.info/FSA/print/handbook/MAR

agreements will not automatically insulate an individual from the risk of sanction for market abuse. This means that individuals will have to be very careful of placing themselves in situations where they may have access to inside information and will have to apply their own judgment as to whether any information they receive constitutes inside information. Companies will need to consider their systems and procedures in this regard. This warning is particularly important because this case has again demonstrated the FSA's strong desire to pursue and prosecute individuals for market manipulation offences.

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