

Pace University

DigitalCommons@Pace

Pace Law Faculty Publications

School of Law

1-1-1991

Enforcement of Securities Laws Violations in the United Kingdom

James J. Fishman

Elisabeth Haub School of Law at Pace University

Follow this and additional works at: <https://digitalcommons.pace.edu/lawfaculty>



Part of the [Securities Law Commons](#)

Recommended Citation

James J. Fishman, Enforcement of Securities Laws Violations in the United Kingdom, 9 Int'l Tax & Bus. Law. 131 (1991), <http://digitalcommons.pace.edu/lawfaculty/109/>.

This Article is brought to you for free and open access by the School of Law at DigitalCommons@Pace. It has been accepted for inclusion in Pace Law Faculty Publications by an authorized administrator of DigitalCommons@Pace. For more information, please contact dheller2@law.pace.edu.

Enforcement of Securities Laws Violations in the United Kingdom

by
James J. Fishman†

INTRODUCTION	132
I. AN OVERVIEW OF THE REGULATORY FRAMEWORK	134
A. LOCI OF REGULATORY AUTHORITY	134
B. SCOPE OF REGULATION	135
C. AUTHORIZATION AND ENFORCEMENT	135
II. ENFORCEMENT POWERS	138
A. HIERARCHY OF ENFORCEMENT POWERS	138
B. MONITORING AND INFORMATION GATHERING	140
1. NOTIFICATION REQUIREMENTS	140
2. POWER TO CALL FOR INFORMATION	141
3. MONITORING THE SROs AND OTHER RECOGNIZED BODIES	141
C. INVESTIGATIVE POWERS	142
D. ENFORCEMENT IN PRACTICE	145
E. COMPLIANCE AND CONTROL POWERS	150
1. DISQUALIFICATION OF FIRMS AND INDIVIDUALS	150
A. AUTHORIZATION OF INVESTMENT BUSINESS	150
B. SIB DISQUALIFICATION ACTIONS AGAINST INDIVIDUALS	151
2. PUBLIC STATEMENTS AS TO MISCONDUCT	152
3. REMEDIES FOR IMPERMISSIBLE TRANSACTIONS	152
A. INJUNCTIONS	152
B. RESTITUTION ORDERS	153
C. VOIDING OF CONTRACTS	154
D. PRIVATE ACTIONS FOR DAMAGES	156
4. POWERS OF INTERVENTION	157
5. WINDING UP	158
6. COMPLIANCE AND CONTROL POWERS OVER RECOG- NIZED BODIES	159
III. THE LIMITS OF ADMINISTRATIVE POWER	161
A. DUE PROCESS REQUIREMENTS	161
B. THE FINANCIAL SERVICES TRIBUNAL	163

† Visiting Professor of Law, Brooklyn Law School; Professor of Law, Pace University School of Law. J.D., Ph.D New York University. A.B., A.M. University of Pennsylvania.

C. ACCESS TO JUDICIAL REVIEW	165
IV. PROSECUTION OF SECURITIES FRAUD AND INSIDER DEALING .	168
A. SECURITIES FRAUD	169
B. INSIDER DEALING.....	173
1. RESTRAINTS ON INSIDER TRADING BEFORE 1980	174
2. THE COMPANY SECURITIES (INSIDER DEALING) ACT, 1985	175
3. THE FINANCIAL SERVICES ACT AND INSIDER DEALING.....	177
4. VIOLATIONS OF THE INSIDER DEALING ACT IN THE LATE 1980S.....	179
5. THE FAILURE OF ENFORCEMENT	184
A. THE ENFORCEMENT RECORD	185
B. ORGANIZATIONAL AND STATUTORY WEAKNESSES .	186
C. JUDICIAL BARRIERS TO ENFORCEMENT - PROCESS, INEXPERIENCE AND CONSERVATISM	188
D. DEREGULATION.....	190
6. CONCLUSION	192
C. MULTILATERAL COOPERATION.....	192
V. THE VIABILITY OF SELF-REGULATION	193
A. THE PANEL ON TAKEOVERS AND MERGERS: A CASE STUDY	195
B. THE LIMITS OF SELF-REGULATORY ENFORCEMENT: THE BLUE ARROW AFFAIR.....	198
CONCLUSIONS	204

INTRODUCTION

In 1986, the United Kingdom's securities markets underwent a two-part revolution. The first part involved the deregulation of the London Stock Exchange (the "Stock Exchange") and the introduction of international integrated financial services firms into this formerly-closed and functionally-segmented marketplace. This development has been called colloquially the Big Bang. The second part of the revolution was the passage of the Financial Services Act (F.S.A.).¹ The F.S.A. created a comprehensive scheme of regulation covering the entire financial services industry. Under this scheme, regulatory powers are officially granted to one government department. In practice, however, these powers have been delegated to a nongovernmental regulatory body, the Securities and Investments Board, and to private self-regulating organizations. Consequently, the British approach to financial

1. Financial Services Act (F.S.A.), 1986, Ch. 60.

services regulation can be described as self-regulation within a statutory framework.²

The above-mentioned developments have been chronicled elsewhere.³ This article examines the record of the United Kingdom in enforcing its securities laws since the passage of the F.S.A. It discusses the information gathering and investigative powers of the responsible governmental agencies and self-regulating organizations, and analyzes the enforcement problems. In addition, the article examines the due process protections in the statute for individuals and firms denied authorization to conduct business or accused of wrongdoing.

The United Kingdom's new regulatory framework reflects political compromises in its attempt to serve conflicting purposes: the encouragement of domestic competition through deregulation of the financial services industry, the promotion of a vigorous financial services sector able to compete in a global trading environment, and the attainment of public policy objectives of safety, soundness, stability, and integrity.⁴ Attendant to market deregulation was the introduction of a more stringent regulatory framework, one of whose goals was to increase investor confidence in the financial services industry as "a clean place to do business."⁵ To create such an environment and to encourage investor confidence, an enforcement scheme had to be implemented that broadened disclosure, improved business practices, and efficiently discovered and sanctioned securities law violators.

An effective securities regulatory framework should hold out the vision to the investor of fairness in the market place. This can be accomplished through increased disclosure so that informed decisions can be made on the basis of accurate information, through prevention of violations, by increased monitoring and reporting requirements, and through prompt, effective, and vigorous prosecution of securities law violations.

Despite the new regulatory framework, securities law enforcement in the United Kingdom could be improved significantly. The enforcement regime has not been able to thwart insider dealing or other fiduciary violations. It has been unable to create an aura of effectiveness. The barriers to effective

2. SECRETARY OF STATE FOR TRADE AND INDUSTRY, FINANCIAL SERVICES IN THE UNITED KINGDOM: A NEW FRAMEWORK FOR INVESTOR PROTECTION, 1985, CMND. SER. NO. 9432, at § 5.1 [hereinafter WHITE PAPER].

3. See Barnard, *The United Kingdom Financial Services Act, 1986: A New Regulatory Framework*, 21 INT'L LAW. 343 (1987); Miller, *Regulating Financial Services in the United Kingdom — An American Perspective*, 44 BUS. LAW. 323 (1989); Peeters, *Re-regulation of the Financial Services Industry in the United Kingdom*, 10 J. INT'L BUS. L. 371 (1988); Pimlott, *The Reform of Investor Protection in the U.K.: An Examination of the Proposals of the Gower Report and the U.K. Government's White Paper of January, 1985*, 7 J. COMP. BUS. & CAP. MARKET L. 141 (1985). N. POSER, INTERNATIONAL SECURITIES REGULATION: LONDON'S BIG BANG AND THE WORLD SECURITIES MARKET (1990).

4. Cf. Kubarych, *International Regulatory Harmonization: The Economic and Financial Environment*, 14 BROOKLYN J. INT'L L. 262-63 (1988); N. POSER, INTERNATIONAL SECURITIES REGULATION: LONDON'S BIG BANG AND THE WORLD SECURITIES MARKET (1990).

5. WHITE PAPER, *supra* note 2, § 3.1(iii).

enforcement include: organizational problems; deficiencies in the enabling statute, particularly the insider dealing act; weaknesses in the self-regulatory system; difficulties in changing attitudes toward certain kinds of behavior; deregulation itself, which has brought together contrasting cultures with differing standards of business behavior; and the globalization of securities markets, which has made enforcement of securities violations more difficult.

This article examines the weaknesses of the present system of enforcement and suggests changes to make it more effective. The article is divided into three parts: an analysis of the enforcement provisions of the F.S.A., the prosecution of securities offenses since its implementation, and the viability of self-regulatory enforcement.

I.

AN OVERVIEW OF THE REGULATORY FRAMEWORK

A. Loci of Regulatory Authority

The F.S.A. created three tiers of authority over the financial services industry. At the top are the Department of Trade and Industry (DTI) and the Bank of England. At a second level is the Securities and Investments Board (SIB), a private agency to which primary regulatory responsibility has been transferred from the DTI. The third tier is comprised of four self-regulating organizations (SROs), seven investment exchanges, eight professional bodies, and two clearinghouses.⁶ These organizations, which are private

6. The SROs and their principal areas of responsibility are: Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA), which regulates independent investment intermediaries; Investment Management Regulatory Organization (IMRO), which regulates investment managers including those of investment trusts, pension funds; operators and trustees of collective investment schemes; and investment advisers to institutional and corporate clients; Life Assurance Unit Trust Regulatory Organization (LAUTRO), which regulates marketing of life insurance policies and collective investment schemes such as mutual funds; and The Securities Association (TSA), which regulates investment businesses involving securities, bonds, derivative products, and ancillary investment management and advice. The Association of Futures Brokers and Dealers (AFBD), which supervised the regulation of investment business involving futures, options, and contracts for differences, merged with TSA in 1991.

The recognized investment exchanges and their markets are: the International Stock Exchange of the United Kingdom and the Republic of Ireland Limited (ISE) (markets in U.K. and foreign equities, gilt-edged and fixed interest stock, and traded and traditional options); the London International Financial Futures Exchange Limited (LIFFE) and LIFFE Options (markets in financial futures and options); the London Commodity Exchange (1986) Limited (London FOX) (markets in futures and option contracts in cocoa, coffee, and sugar); the London Metal Exchange Limited (LME) (markets in futures and option contracts in various nonferrous metals and silver); the Baltic Futures Exchange (BFE) (futures contracts in freight, meat, potatoes, grain, and soya bean meal; option contracts in potatoes and grain); and the International Petroleum Exchange of London Limited (IPE) (futures contracts in gas oil, gasoline, heavy fuel oil, and crude oil; option contracts in gas oil).

The recognized professional bodies are: the Chartered Association of Certified Accountants, the Institute of Actuaries, the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Insurance Brokers Registration Council, the Law Society, the Law Society of Northern Ireland, the Institute of Chartered Accountants in Ireland, and the Law Society of Scotland.

functionally-organized industry bodies, directly monitor the activities of their members.

B. Scope of Regulation

Compared to U.S. securities legislation, where discrete statutes segment the regulation of the financial services industry, the swath of the F.S.A. is quite broad. The statute regulates the sale of stocks and bonds, life insurance, mutual savings banks, collective investment schemes, such as mutual funds, limited partnerships, investment syndicates, and all other investment businesses. In addition, the F.S.A. regulates the marketing of investments, including newspaper advertisements. It also restricts "cold calling," the practice of making unsolicited calls or visits to potential investors. Providers of these financial services must be authorized to conduct business or face civil or criminal penalties. There are also extremely detailed conduct of business provisions that cover broker-customer relationships, capitalization requirements, segregation of funds and the operation of clients' accounts, indemnity rules, and client compensation.

To facilitate further the enforcement of the securities laws, the F.S.A. vests the responsible regulatory bodies with broad powers of investigation and prosecution. At the same time, it attempts to curb regulatory overreaching by providing due process protections and by charging the DTI with oversight of the SROs. The statute also provides the basis for international cooperation and reciprocity with foreign regulators.

Still, some areas of financial regulation remain outside of the new regulatory framework created by the F.S.A. or are only mentioned tangentially. Insider trading enforcement remains almost exclusively within the DTI. The London Stock Exchange's rules still govern the official listing of securities, that is, the bringing of new issues to market and the prospectus requirements for those securities. Transactions in the wholesale money market by institutions listed by the Bank of England and Lloyds, the reinsurance association, remain outside of the new framework. The Takeover Panel, a private body, regulates mergers and tender offers through the City Code on Takeovers and Mergers. In each of the above areas, investigation and enforcement responsibilities are divided among several departments.

C. Authorization and Enforcement

Securities regulation is a process of discrete stages that cumulatively should result in an effective system of enforcement. Financial services enforcement in the United Kingdom has three principal components: 1) Prevention, including the screening and elimination from the financial services

The two recognized clearinghouses are GAFTA Clearinghouse Company Ltd. and the International Commodities Clearing House Ltd. SECURITIES AND INVESTMENTS BOARD, REPORT OF THE SECURITIES AND INVESTMENTS BOARD FOR 1988/89 9-10, 12-13 (1989) [hereinafter SIB ANNUAL REPORT].

industry of all obviously unsuitable firms and individuals; information gathering consisting of the creation of an effective monitoring and reporting system extending from within the firm itself to the self-regulating body to the SIB; and 3) deterrence, including prompt prosecution and sanctioning of violators. These components are designed to combat three of the greatest problems of the previous system of securities protection: deficiencies in evaluation at the entry level, breakdown of shared norms of behavior, and ineffective enforcement of violations.

The government designed the F.S.A. to protect investors from securities law violations through both preventative measures and the vigorous prosecution of wrongdoers. Prevention is pursued primarily through regulatory control of "investment business" authorization. Under the new regulatory framework, no firm can engage in an investment business unless it is authorized to do so by the SIB or by an SRO after a review of its background, finances, and business plans.⁷

The definition of investments sets the boundary of the regulated activities and is interpreted quite broadly. The rationale for the system of authorization is that allowing only fit and proper persons to engage in investment business will be the most effective, cost-efficient way to prevent abuse. There are severe criminal and civil sanctions for operating an unauthorized investment business. Similar to the U.S. system, there are ongoing disclosure requirements by firms.

The protection of investors was the most important rationale for the system's introduction.⁸ Several approaches can be used to ensure protection. The most important is preventive action. The authorization process is designed to create a filter so that firms with questionable capabilities, assets, or business practices are prevented from entering the financial services industry, thereby protecting the unsuspecting public. However, if authorization requirements were unreasonably high, entry would be excessively difficult. Competition within the industry would suffer, and public transaction costs might increase. Thus, a balance must be reached with standards sufficiently high to protect the public, yet flexible enough to permit entry of new firms.

At the other end of the continuum, effective enforcement against those who have broken the rules provides an important deterrence against future violations. Enforcement efforts consist of early identification of violators, timely investigation, effective prosecution, and appropriate sanctions against those convicted.

Prosecution of commercial fraud is difficult and requires vast resources. In addition, enforcement by private bodies must be weighed against the danger of arbitrary action against the accused. The United Kingdom's enforcement regime has been ineffective because of the lack of prosecutorial experience, the absence of full investigatory powers by certain enforcement

7. F.S.A., *supra* note 1, § 3.

8. WHITE PAPER, *supra* note 2, at 1.

agencies, overlapping and conflicting lines of authority and a dearth of trained personnel.

The F.S.A. provides the SIB and the recognized bodies with a full arsenal of information gathering, intervention, and investigatory powers and also provides elaborate rights of due process and appeal to the accused. Some of the enforcement powers are exercisable concurrently with the Secretary of State. The recognized bodies' authority is based upon contract, as opposed to statute.

The principal powers of intervention and enforcement are investigatory powers, civil and administrative actions, and criminal prosecution. The F.S.A. creates several offenses for which the SIB is the prosecuting authority.⁹ Perhaps the most important offense that the SIB has the right to prosecute is unauthorized engagement in an investment business.¹⁰ Most criminal offenses under the act carry maximum sentences of two years' imprisonment and/or a two thousand pound fine.

With regard to civil and administrative actions, the SIB can seek injunctions and restitution orders against individuals who have carried on business without authorization or have breached rules and regulations.¹¹ The restitution order is a device to restore monies or property to investors who have suffered losses as a result of prohibited transactions. In addition, the SIB can liquidate firms and obtain administrative orders to oversee businesses under the Insolvency Act of 1986.¹²

In addition to injunctions and restitution, the SIB and the SROs can intervene in the affairs of a firm authorized by them and impose restrictions when there has been a breach of the F.S.A. or where there is a need to protect investors.¹³ For example, the SIB can disqualify persons from being employed in an investment business if they are not "fit and proper" and it can issue public statements regarding a person's misconduct.¹⁴

Broad oversight and investigative powers permit inquiry into the affairs of individuals or investment businesses.¹⁵ The designated agency is also charged with oversight responsibilities of collective investment schemes.¹⁶

While the SIB has broad monitoring and investigative authority, the powers of the recognized bodies are limited by their contractual relationships with members. Members' acceptance of recognized bodies' disciplining and monitoring authority is the *quid pro quo* for their authorization. Because they lack subpoena powers, the recognized bodies coordinate their enforcement efforts with the SIB. Perhaps the most important enforcement tool is

9. F.S.A., *supra* note 1, § 201(4).

10. *Id.* § 4.

11. *See id.* § 72.

12. *Id.* §§ 72-74.

13. *See id.* § 65.

14. *Id.* §§ 59-60.

15. *See id.* § 105.

16. *See id.* §§ 75-95.

the requirement of periodic disclosure to the investor and to regulators. The British system creates an ongoing disclosure framework, analogous to the requirements of Section 12(g) corporations under the Securities and Exchange Act of 1934.¹⁷ The F.S.A. has given the SIB broad authority to mandate a continuous flow of information that provides an early warning system for regulators and creates an important paper trail if investigations are necessary.

II.

ENFORCEMENT POWERS

A. Hierarchy of Enforcement Powers

The effectiveness of the regulatory scheme rests upon the nature and scope of enforcement tools. The F.S.A. creates a hierarchical and overlapping enforcement system to monitor firms and individuals, investigate reported problems, and prosecute violators.

The enforcement process commences with the individual firm, which must establish compliance procedures to ensure that the firm and its employees adhere to the SRO's rules. When the firm is authorized by an SRO, it agrees to abide by the SRO's rules and to provide such information as the SRO demands. In fact, SROs are defined as bodies that regulate the conduct of any kind of investment business by enforcing binding rules upon its members or others subject to its control.¹⁸

The SROs have the most direct monitoring, compliance, and enforcement powers over their firms,¹⁹ much as the stock exchanges or the National Association of Securities Dealers can discipline member firms in the United States. Authorized individuals and firms must agree to abide by the rules of their SROs. The SROs require that firms develop internal compliance systems.

The SROs have broad information-gathering powers over their members, which is crucial to effective oversight. This aids them in early identification of problems. The statute provides that the SROs will have the equivalent powers over their members as the SIB would have over directly authorized firms.²⁰ Thus, SROs can require a firm to provide information or refrain

17. 15 U.S.C.A. § 78l(g)(2) (1988). Section 13(a) requires corporations to file annual and quarterly reports and other information that the Securities and Exchange Commission requires. 15 U.S.C.A. § 78m(a) (1988).

18. F.S.A., *supra* note 1, § 8(1).

19. The SRO is responsible for the day-to-day enforcement of investment businesses. It is subject to the SIB's rules and criteria for recognition. Only after the SIB is satisfied that the SRO will be an effective regulator and can meet the criteria outlined in the statute will the SRO receive recognition. Among the criteria are: that the SRO have an effective scope rule to preclude its members from carrying on an investment business of a kind with which the SRO is not concerned; that the SRO demonstrate commitment and competence to regulate the investment business it seeks to cover; an indication that the SRO's rules and practices are at least as effective as the SIB's own; and that the SRO willingly agree to cooperate and share information with the SIB. F.S.A., *supra* note 1, sched. 2.

20. F.S.A., *supra* note 1, sched. 2, ¶ 3.

from participating in certain activities. The SRO can fine, discipline, expel, or otherwise sanction its members.²¹

Because SROs lack the power of subpoena, they are unable to seek documents or information from third parties who are not members of the SRO or not engaged in an investment business themselves. In practice, this means that most SRO investigations will be in cooperation with the SIB, which can exercise its investigatory powers against third parties.²² In the alternative, the SIB can delegate to the appropriate officials in the SRO the authority to conduct the investigation on the SIB's behalf.²³

The SIB monitors firms that are directly authorized by the SIB and are not members of an SRO. The SIB is also responsible for recognizing and monitoring the performance of the SROs. Only after the SIB is satisfied that the SRO will effectively regulate its firms will it be recognized.

The SIB's investigatory and enforcement powers over individual firms and individuals are usually indirect, but it can intercede if the SRO is not aggressively fulfilling its responsibilities. An ineffective or recalcitrant SRO can be disciplined by the SIB. In conducting investigations, the SIB can seek information from the Bank of England or the DTI.²⁴

The SIB's enforcement responsibilities end at the investigatory stage. It must turn over its efforts to the Serious Fraud Office (SFO)²⁵ and the DTI for prosecution. Historically, all investment businesses and other corporations were subject to the DTI, which retains broad powers of investigation into the affairs of corporations, their employees, and their dealings in securities.²⁶ All of the enforcement bodies remain subordinate to the DTI, a governmental agency overseen by the Secretary of State for Trade and Industry, which has ultimate responsibility over the investor protection framework.

The Secretary of State can prescribe any rule that the F.S.A. mandates or authorizes.²⁷ However, he has transferred many of his powers under the statute to the SIB.²⁸ Among the powers transferred by the Secretary of State is rulemaking authority. Except for the few directly authorized firms, the SIB exercises largely secondary or coextensive compliance and enforcement powers, as discussed above. However, its indirect authority is vast through its rulemaking powers, the heart of any regulatory system, and its supervision of the SROs.

21. *Id.* (§ 3 confers upon the SRO the same powers of enforcement as conferred upon the SIB in F.S.A. ch VI of part I).

22. *Id.* § 105(2).

23. *Id.* § 106.

24. *Id.* sched. 13, § 3; sched. 9, § 13(1).

25. *See infra* pp. 73-74 & note 225.

26. *See* J.H. FARRAR, *COMPANY LAW* 436-44 (1985).

27. F.S.A., *supra* note 1, § 205. This rulemaking authority is subject to annulment by resolution of either house of Parliament.

28. *Id.* § 114 as amended by Companies Act 1989, ch. 40, sched. 23, 12 (1989) (giving the Secretary of State the authority to transfer power).

The SIB's rules, which now consist of ten principles and forty core rules, have a significant impact on the whole financial services sector. To be recognized by the SIB, the self-regulating body must have rules that provide an "adequate" level of investor protection. This means that the recognized bodies' rules are similar to those of the SIB.

The F.S.A. requires the SIB to promulgate rules mandating high standards of integrity and fair dealing in the conduct of investment business.²⁹ It also must make such rules that are necessary relating to firms' financial resources,³⁰ cancellation of investment agreements by investors,³¹ and notification by investment businesses of various circumstances to their SRO or the SIB.³² The SIB must also make provisions to meet the enabling statutes' objective of ensuring investor protection.³³ As a result, a complex network of norms, procedures, and regulations bind investment businesses.

B. Monitoring and Information Gathering

Monitoring and information gathering powers are important preventives to rules violations. They force firms to create procedures that will aid in compliance and provide, in some cases, incriminating paper trails. They enable regulators to identify problems early, act as a deterrent to wrongdoing, and assist in the ability to gather evidence. The SIB's statutory monitoring, information gathering, and investigatory powers have a spill-over effect on the SROs, which have similar rules or practices regulating their members.

1. Notification Requirements

Pursuant to Section 52(1) of the F.S.A., the SIB has promulgated notification regulations requiring directly authorized persons to disclose certain information upon the occurrence of specific events. The SIB also requires authorized persons to furnish certain financial and business information on a periodic basis.³⁴ The notification regulations apply to a broad range of information, including the nature of the investment business, the nature of any

29. *Id.* § 48. Schedule 8 requires that the SIB rules mandate disclosure of material facts such as commissions, interests, and the capacity in which the firm deals with a client. In addition, the SIB must require firms to: disclose sufficient information to ensure informed decisions by investors; provide for protection of customers' property; and keep records and provide for their inspection. *Id.* sched. 8.

30. *Id.* § 49.

31. *Id.* § 51.

32. *Id.* § 52.

33. These rules include: the promotion of high standards of integrity and fair dealing in the investment business; the subordination by authorized persons of their interests to those of their clients and to act fairly between clients; the disclosure of material interests and facts to the customer; and the disclosure of the capacity in which and the terms on which the firm acts, enabling investors to make informed decisions; and the protection of investors' property. *Id.* sched. 8.

34. *Id.* § 52(2), (4). The notification regulations do not apply to firms authorized by an SRO or other recognized body; however, because of the equivalence requirement, the SROs have promulgated similar requirements. *See id.* § 52(3).

other business carried on in connection with the investment business, any proposal by an authorized person to alter the nature or extent of investment business carried on, the financial position of an authorized person regarding the investment business or any other business conducted, and any property or money held by an authorized person on behalf of other persons.³⁵ In addition, the notification regulations require that annual reports must be filed by each firm.³⁶

2. *Power to Call for Information*

Under Section 104(1), the SIB can require directly authorized and automatically authorized firms to provide such information as may be reasonably required for the exercise of its functions under the act.³⁷ The power to call for information is an informal and preliminary step to an investigation, analogous to a "request for cooperation" from the Securities Exchange Commission. If the request is made, the information must be produced within a reasonable time and verified as the SIB specifies.³⁸ Failure to comply with a call for information can lead to statements of misconduct, injunctions or restitution orders, or an action for damages.³⁹ However, the SIB's powers are checked by statutory due process protections of individuals and firms. In addition, the SIB is required to follow principles of public, or "common," law. Judicial review is available if the designated agency's actions are arbitrary or capricious.⁴⁰

3. *Monitoring the SROs and Other Recognized Bodies*

The SIB has direct monitoring responsibilities over SROs and other recognized bodies. It has promulgated notification regulations requiring the recognized body to provide information at specified times or in respect of such periods specified in the regulations.⁴¹ If a recognized organization breaches,

35. *Id.* § 52(4)(a)-(f). The SIB's regulations are divided into three parts: the first applies to directly authorized firms under section 25; the second, to insurance companies and registered friendly societies pursuant to sections 22 and 23; and the third to European Community-based firms authorized under section 31.

36. The SIB's Financial Services (Appointment of Auditors) Rules of 1987 (revised, 1988) require directly authorized firms to appoint an auditor before they engage in an investment business. *See id.* § 107(1). (The auditor must be retained until he has prepared the firm's financial statement for its second financial year.) *See* SECURITIES AND INVESTMENTS BOARD, FINANCIAL SERVICES RULES AND REGULATIONS, ch. 2, pt. 10, § 10.02(4) (*as amended* 1988) [hereinafter SIB RULES]. The auditor must be given access to any information he feels is necessary to carry out his responsibilities. If there is good reason to do so, the SIB can direct a firm to submit to a second audit. F.S.A., *supra* note 1, at § 108. Knowingly furnishing an auditor misleading information is a criminal offense. *Id.* § 111.

37. *Id.* § 104(1) (discussing automatic authorization).

38. *Id.* § 104(3).

39. *Id.* §§ 60-62, 104(4).

40. Morse & Walsh, *Monitoring, Enforcement and Challenge of Decisions*, in 1 FINANCIAL SERVICES LAW AND PRACTICE 356-57 (A. Whittaker ed. 1989).

41. *See* F.S.A., *supra* note 1, § 14. Information must be given in the specified form and verified in a specified manner. *Id.* § 14(4).

revokes, or adds to its rules, it must inform the SIB of such action within seven days.⁴² Violation of the notification requirements is not a criminal offense, but the SIB could revoke recognition, seek a compliance order in court,⁴³ or, after consultation, direct the alteration of the rule or alter the rule itself so as to protect the investor.⁴⁴

Pursuant to Section 14,⁴⁵ the SIB promulgated the Financial Services (Notification by Recognized Self-Regulating Organizations) Regulations 1987,⁴⁶ which require the SROs to notify the designated agency upon the occurrence of specified events. These events are: appointment or cessation of appointment of the management team of an SRO; constitutional changes; imposition of fees and charges; delegation of monitoring of compliance functions; dismissal of officer or employees for misconduct or their resignation while under investigation for misconduct; or insolvency. In addition, SROs must provide periodic information such as annual reports, auditors reports, and quarterly financial results.⁴⁷ SROs are also required to submit information to the SIB about their member firms.⁴⁸ SROs must compile and report statistics relating to the firms' adherence to SRO rules for each quarter of the preceding financial year.⁴⁹ The SIB may require any recognized body to furnish it with such information as is reasonably necessary for the exercise of the SIB's functions under the act.⁵⁰

C. Investigative Powers

The F.S.A. provides the SIB and the recognized bodies with broad investigatory powers. Prior to enactment of the F.S.A., the Companies Act of 1985 had granted DTI the exclusive power to seek information from investment businesses.⁵¹ Under section 104 of the F.S.A., these powers, as well as

42. *Id.* § 14(6).

43. *Id.* § 12.

44. *Id.* § 13.

45. *Id.* § 14.

46. SIB RULES, *supra* note 35. (Notification by Recognized Self-regulating Organizations) (1987).

47. *Id.* at rule 2. There are also notification regulations for other recognized bodies. See *infra* Part III.

48. This information includes membership; refusal, withdrawal or suspension of membership; investigation into the activities of a member; the investigation's findings; any action taken pursuant to such finding; intervention against a member; disciplinary actions against a member; information from an auditor communicated to the SRO pursuant to the financial services (appointment of auditors) rules; insolvency of member firms; and any evidence that a person or member firm has committed an offense.

49. The information includes the number of firms in breach of financial adequacy regulations; the names of any members in breach on more than one occasion during the year; other submissions, such as firms unable to comply with the SRO's rules; the number of its members subject to inspection; complaints received presented on a quarterly basis and distinguished between those about the SRO's performance and those about SRO members' activities. The resolution of the complaints also must be submitted.

50. F.S.A., *supra* note 1, § 104(2).

51. It also has investigatory powers under the Police and Criminal Evidence Act of 1984 and the Banking Act of 1979.

additional investigative powers, were granted concurrently to the DTI and the SIB. However, section 105 limits this capability by providing that the power to investigate member firms under the control of recognized bodies resides with these bodies unless they ask the SIB to participate or they fail to pursue a satisfactory investigation.

The SIB's investigatory powers are relevant to the regulation of unauthorized firms that may engage in investment business; authorized firms directly regulated by the SIB; interim authorized firms; or situations where the affairs of the authorized firm that is a member of an SRO or recognized professional body present special problems which lead the SRO or recognized body to seek the SIB's statutory assistance.⁵² The purpose of investigation is to gather information for a subsequent civil or criminal action.

In most cases involving member firms, the locus of investigatory responsibility lies with the recognized body while the SIB remains in a backup position. However, the SIB's power to subpoena "connected persons,"⁵³ such as the investigated party's banker, auditor, or solicitor, is an important investigative power upon which the recognized bodies frequently rely. Because of their inability to investigate third parties themselves, SROs seek the assistance of the SIB. It is important to note, however, that the SIB's investigative powers with respect to connected persons is limited by specific legal, professional, and bank privacy privileges.⁵⁴

Under its specific investigatory powers, the SIB can require a person under investigation to appear before it, to produce specified documents, and to answer questions.⁵⁵ Failure to comply with an investigatory request can lead to severe consequences: namely, a criminal conviction.⁵⁶ Additionally, when the SIB has reasonable cause to believe certain specified violations of the F.S.A. or other related criminal offenses — such as insider dealing — have occurred, it may obtain a warrant to search for documents.⁵⁷ This power must be exercised concurrently with the DTI. It is usually used only after a party has refused to comply with a request to produce documents.⁵⁸ Although the SIB's power to conduct searches is broad, it is limited by the requirement that there be a "good reason" for the investigation and that the desired documents be "specified."⁵⁹ Given the procedures for obtaining warrants and the demands on the SIB's stretched resources, it seems unlikely that this investigative power will be abused or overused.

One way in which the SIB can expand its investigative power is to appoint an outside party to conduct an investigation. Under section 105, if the

52. SIB ANNUAL REPORT 1989/90, *supra* note 6, at 19.

53. F.S.A., *supra* note 1, § 105(a).

54. *Id.* § 105(6)(7).

55. *Id.* § 105(3).

56. *Id.* § 105(10).

57. *Id.* § 199(2).

58. A. WEDGWOOD, G. PELL, L. LEIGH, & C. RYAN, A GUIDE TO THE FINANCIAL SERVICES ACT 109 (1980) [hereinafter A. WEDGWOOD, G. PELL].

59. F.S.A., *supra* note 1, § 105(1)(4).

SIB has good cause to investigate someone, it can assign all of its powers to a third party, provided that the scope of the investigation is limited to a specifically named individual.⁶⁰ By appointing compliance officers in firms or SRO board members as outside investigators the enforcement efforts of the firms and the SROs can be greatly enhanced.

In its first two years, the SIB investigated forty firms. Fifteen were authorized, fifteen had received interim authorization, and ten were unauthorized. Out of those forty instances where section 105 powers were invoked, twenty-one required further action.⁶¹ Many investigations resulted in follow-up action by an SRO, winding up actions by the SIB,⁶² an SIB injunction or restitution action,⁶³ action by the DTI, or criminal prosecution.

The SIB's most significant exercise of investigatory powers concerns inquiries of unauthorized investment activities. From April 29, 1988 to March 1990, the SIB undertook 330 investigations of unauthorized investment business of which fifty-seven required further action.⁶⁴

The effectiveness of the SIB's enforcement has sharply contrasted with the maladministration of the DTI. In several highly publicized actions since the enactment of the F.S.A., the SIB moved swiftly to suspend the authorization of, and later to wind up, several companies involved in questionable selling activities to unsophisticated investors. Prior to the creation of the SIB, suspected violators customarily ignored the DTI's warnings. Sluggish investigations by the DTI resulted in large losses by investors. All too frequently, the DTI produced reports long after the financial scandals had unraveled. By the time action was taken, the funds had disappeared. The SIB's powers have enabled it to act much more swiftly than enforcement agencies operating prior to the enactment of the F.S.A..

DTI has been burdened by a patchwork of responsibilities, bureaucratic sluggishness, a severe shortage of investigative staff, a lack of investigative tradition and initiative, and a poor reputation within the government and without.⁶⁵ It oversees the enforcement of company law (corporate law) legislation, which includes the registration of companies and filing of documents in relation to those companies. It conducts investigations into company affairs and monitors corporate behavior. The Department also supervises insurance companies, enforces the prohibitions against insider trading, and represents the Government's international trade policy in the European Community (EC) and other international organizations. It directs and initiates Government policy toward industry including antitrust policy, fair trading,

60. *Id.* § 106. Additionally, the SIB has broad power to investigate and subpoena unit trusts, other collective investment schemes, and their managers. In matters involving collective investments, the SIB appoints an inspector who issues a report that may be published. *Id.* § 94.

61. SIB ANNUAL REPORT 1989/90, *supra* note 6, at 20-21.

62. F.S.A., *supra* note 1, § 72.

63. *Id.*

64. SIB ANNUAL REPORT 1989/90, *supra* note 6, at 21.

65. See J.H. FARRAR, *supra* note 26, at 436-44.

consumer protection, regional policy, and science policy and research. In short, the Department is too sprawling to be effective⁶⁶.

In contrast, the SIB, with a narrower focus, has been able to intervene quickly and effectively in tandem with the SROs. The notification requirements and the monitoring system provide an effective early warning system, allowing the SIB to act early and pre-emptively. In the financial services sector, an SIB request for an injunction often means that a firm will collapse financially shortly thereafter whereas an ongoing investigation by the DTI allows the violating firm to conduct its business as before until the probe is completed.

D. Enforcement in Practice

Typical of the difference between the SIB and the DTI were their respective actions in 1988 in connection with DPR, a futures and options broker that used high pressure tactics (e.g., repeatedly calling potential investors) to sell high risk futures and options with higher commission charges. In order to create the appropriate atmosphere to encourage unsophisticated investors to part with their savings, the firm played a recording of a frenetic trading room during the telephone call. DPR was a classic "boiler room" operation. Commissions were five times those of reputable firms.⁶⁷ Accounts were churned, and financial statements difficult to obtain.

Although the DTI investigated the scam, its response was too late, too slow, and too limited. According to evidence accumulated by *The Times*, the DTI had received a stream of complaints about DPR's questionable business tactics for nearly a year before it acted. The Department also had received warnings from legitimate futures firms.⁶⁸

In contrast, the SIB moved quickly and effectively once it became aware of the case. DPR had applied to the Association of Futures Brokers and Dealers (AFBD) for authorization. While waiting for final authorization, it was approved on an interim basis. AFBD had received several letters complaining of high pressure sales techniques.⁶⁹ It turned those complaints over to the SIB and in July, 1988, the SIB rejected DPR's application. The SIB then moved to put DPR out of business. On a Monday it suspended DPR pursuant to section 28⁷⁰ on grounds that it was not a fit and proper person to

66. P. HENNESSY, WHITEHALL 431 (1989).

67. Lever, *Investors Count Cost of Dealing with DPR*, *The Times* (London), July 13, 1988, at 29, col. 1.

68. *A Nasty Trade Pattern*, *The Times* (London), July 13, 1988, at 17, col. 1.

69. Hargreaves & Tucker, *DPR Case Takes Shine Off Futures*, *Fin. Times*, July 14, 1990, at 4, col. 1.

70. F.S.A. section 28 states in part:

Section 28 Withdrawal and suspension of authorization 28(1) [Power of Secretary of State] The Secretary of State may at any time withdraw or suspend any authorization granted by him if it appears to him -

(a) that the holder of the authorization is not a fit and proper person to carry on the investment business which he is carrying on or proposing to carry on; or

carry on the investment business in which it was engaged. Then, SIB sought an injunction under section 61.⁷¹ On Wednesday of the same week, the SIB petitioned the High Court and received a winding up order pursuant to section 72.⁷² At that time, DPR was still solvent. Since DPR had only received interim approval from the Association of Future Brokers and Dealers, the futures SRO, it was subject directly to the SIB's enforcement powers. The SIB commenced an investigation to determine whether there was fraud or criminal conduct. Its report was forwarded to the SFO so that criminal action could be taken.

The principals of DPR eventually were acquitted of criminal charges of "dishonest trading," a result that may reflect more on the SFO's prosecutorial skills than DPR's blamelessness.⁷³ After the principals were acquitted, the AFBD still refused to authorize them to conduct a futures business and

(b) without prejudice to paragraph (a) above, that the holder of the authorization has contravened any provision of this Act or any rules or regulations made under it or, in purported compliance with any such provision, has furnished the Secretary of State with false, inaccurate or misleading information or has contravened any prohibition or requirement imposed under this Act. F.S.A., *supra* note 1, at § 28.

The Secretary of State has delegated the power of withdrawal and suspension to the S.I.B. *Id.* at § 114.

71. F.S.A. Section 61 states in part:

61(1) [Power of Court on application by Secretary of State] If on the application of the Secretary of State the court is satisfied

(a) that there is a reasonable likelihood that any person will contravene any provision of

- (i) rules or regulations made under this Chapter;
- (ii) sections 47, 56, 57, or 59 above;
- (iii) any requirements imposed by an order under section 58(3) above;
- or
- (iv) the rules of a recognised self-regulating organisation, recognised professional body, recognised investment exchange or recognised clearing house to which that person is subject and which regulate the carrying on by him of investment business or any condition imposed under section 50 above;

(b) that any person has contravened any such provision or condition and that there is a reasonable likelihood that the contravention will continue or be repeated;

or

(c) that any person has contravened any such provision or condition and that there are steps that could be taken for remedying the contravention, the court may grant an injunction restraining the contravention or, in Scotland, an interdict prohibiting the contravention or, as the case may be, make an order requiring that person and any other person who appears to the court to have been knowingly concerned in the contravention to take such steps as the court may direct to remedy it. *Id.* § 61.

72. F.S.A. section 72 states in part:

Section 72 Winding up orders

72(1) [Power of court to wind up] On a petition presented by the Secretary of State by virtue of this section, the court having jurisdiction under the Insolvency Act 1986 may wind up an authorised person or appointed representative to whom this subsection applies if -

- (a) the person is unable to pay his debts within the meaning of section 123 or, as the case may be, section 221 of that Act; or
- (b) the court is of the opinion that it is just and equitable that the person should be wound up.

73. See Tucker, *Four Cleared of Dishonest Trading*, *Fin. Times*, July 13, 1990, at 18, col. 1.

the SIB continued to seek restitution of 1.7 million pounds pursuant to sections 61(3) and 61(4) of the F.S.A.⁷⁴

Another case demonstrates even more vividly the DTI's deficiencies and the SIB's capacity to act swiftly. This case involved Barlow Clowes (BC), a fund management group that had received 180 million pounds from investors. BC was founded by Elizabeth Barlow and a high living Manchester resident, Peter Clowes in 1973. Barlow had fled the country in 1981 just before the collapse of a brokerage firm with which she was involved. Clowes had been closely associated with Bernard Cornfield, a participant in the Investors Overseas Services scandal of the 1960s. BC had subsidiaries and connected companies in places such as Gibraltar and Geneva. Nearly 18,000 investors, many of them retired persons, invested in Barlow Clowes companies.

Originally, BC promised high yields through "bond-washing," a process of converting income from gilts (government securities) into equities, which offered tax advantages. "Bond-washing" was outlawed in 1985, except by small investors, but BC continued to promise extremely high yields. In addition, BC used high interest rates to entice investors to deposit their funds in Gibraltar rather than London. For example, in December 1987, BC granted a 4.2 percent return to investors in London, and a 10.7 percent return on funds invested via Gibraltar. Most of the money went offshore where it was loaned to other Clowes companies.⁷⁵ In the 1980s, nearly 130 million pounds was shifted to Gibraltar, and seven to fourteen million pounds to Geneva.⁷⁶ There were also accounts in Jersey, the Channel Islands, the Isle of Man, and elsewhere.⁷⁷

Warnings about Barlow Clowes activities flowed into the DTI for several years before it finally acted. As early as 1984, the National Association of Securities Dealers and Investment Managers (NASDIM), a self-regulating organization,⁷⁸ had alleged that BC had been illegally trading securities for over a year without obtaining a securities license or joining NASDIM.

Even local authorities and other government offices had become suspicious of BC's activities. One year before the firm collapsed, the Regional Crime Squad in Manchester commenced an investigation of BC after receiving information about lavish spending by its employees and the shipment of

74. See Bennett, *Regulators May Act to Recover Pounds 1.7 m. From DPR*, The Times (London), July 14, 1990, at 40, col. 1.

75. Lever, *DTI Breached Rules Over New Clowes License*, The Times (London), July 22, 1988, at 21, col. 2; Lever, *Jet-set Lifestyle of Peter Clowes*, The Times (London), June 16, 1988, at 23, col. 2; Lever, *Barlow Clowes Victims Vent Anger on DTI*, The Times (London), June 24, 1988, at 1, col. 5.

76. Lever, *Barlow Firm Is Closed in Gibraltar*, The Times (London), June 8, 1988, at 25, col. 8.

77. Lever, *Interest Free Loans Made to Clowes Firms*, The Times (London), June 10, 1988, at 25, col. 2.

78. NASDIM alleged that Barlow Clowes had been traded illegally for over one year, without obtaining a securities license or joining NASDIM. Under the Prevention of Frauds (Investments) Act, this was a criminal offense.

cash abroad on chartered airplanes. The Regional Crime Squad placed the file containing the product of the investigation in its "difficult tray." No further action was taken.⁷⁹ The Inland Revenue Department had also been tipped off about conspicuous expenditures by BC officials, and had conducted a preliminary investigation. In 1984, the Stock Exchange began to deliver warnings to the government and the Bank of England, and in 1987 refused to grant membership to BC.⁸⁰ In neither case was any substantive action taken.

Despite these warnings and investigations, the DTI issued a securities license to BC on October 28, 1985. This license was renewed even though the statutorily required auditors' reports had not been filed.⁸¹ Not until November 1987, did the Department commence an investigation.

Initially, the DTI defended its inaction by arguing that BC was a partnership rather than a corporation, and therefore it was not subject to the enforcement and investigative powers granted to the DTI in the Companies Act. However, this argument was plainly incorrect, since the DTI had required BC to incorporate before it received its license. Not surprisingly, the DTI was roundly criticized in the City and beyond for proffering this flimsy justification. Moreover, under the Prevention of Frauds (Investments) statute, the DTI and the Director of Public Prosecutions were empowered to prosecute any securities firm that was neither licensed nor exempt, regardless of its incorporation status.⁸² Privately, the Department conceded that it could not investigate each applicant because of understaffing and that licensing had become a process of registration, rather than review and approval.

Concurrent with the DTI, the SIB commenced its own investigation in November 1987, by appointing investigators to examine the affairs of one corporation in the Barlow Clowes group, Barlow Clowes Gilt Managers Limited. By April 1988, the investigators' report had been completed. The SIB uncovered evidence of falsified client records and accounting figures, and of lending to corporations controlled by Clowes which had nothing to do with financial services.⁸³ Within days of the investigators report, the SIB had successfully petitioned for a winding up order. The investors were the big losers in this scam. While the perpetrators have been caught in a mire of civil and criminal legal proceedings, the scam was uncovered too late for the investors' money to be saved. Unfortunately, the investors were not covered by the industry-wide compensation scheme since BC had only received interim authorization under the new F.S.A. regulatory scheme.

79. *Lever, Police Knew a Year Ago of Clowes Danger Signs*, The Times (London), June 25, 1988, at 1, col. 7.

80. *Lever, City Shunned Barlow Clowes*, The Times (London), June 30, 1988, at 1, col. 2.

81. *Lever, DTI Accused over Clowes Deals*, The Times (London), June 10, 1988, at 11, col. 1.

82. *Lever, DTI Under Fire over Clowes*, The Times (London), June 11, 1988, at 25, col. 2.

83. *Lever & Fletcher, Papers Were Shredded at Clowes HQ*, The Times (London), June 11, 1988, at 1, col. 1.

In the aftermath of this debacle, the government commissioned two studies of its enforcement efforts in the case. One of these concluded that there had been significant maladministration by the DTI and that if matters had been handled properly, the operations of BC would have been brought to a halt before the money was lost. The report recommended government compensation to investors.⁸⁴ Although the government did not accept the report or admit legal liability, it offered 150 million pounds in compensation to the eighteen thousand defrauded investors.⁸⁵

More than any other case, BC illustrates the weaknesses in the DTI's enforcement capabilities and the need for improved coordination among enforcement agencies.

Unfortunately, Barlow Clowes is not merely a legacy of the old system. Under the F.S.A., the DTI still retains enforcement responsibilities and, as revealed by BC, a passive bureaucratic approach pervades the organization. Barlow Clowes also demonstrates the difficulties associated with investigating and prosecuting against sophisticated transnational commercial crime, and highlights the need for coordination among enforcement agencies. The Barlow Clowes affair was just the kind of financial fraud for which the F.S.A. was designed, but failed, to prevent. However, a silver lining to the BC cloud may be found in the good publicity received by the SIB.

In contrast to the DTI's procrastination and maladministration, the SIB acted quickly and effectively once it became involved. The key to the different responses of the two agencies is that the investor protection model of the F.S.A. is grounded in prevention whereas the DTI's enforcement approach is reactive.

The greatest strength of self-regulatory enforcement is not so much its speed and effectiveness of prosecution, nor the deterrent effect of its sanctions. Rather, it lies in the ability to avert wrongdoing. The authorization process, whereby the firm must demonstrate its fitness to enter the financial services industry, weeds out fringe operators because it shifts the burden of proof from the regulator to the firm.

Thus, DPR and other questionable firms were caught by the SIB in the authorization net. The SIB could act quickly when abusive practices were brought to its attention. In contrast, the scope of the DTI's responsibilities, the lack of an investigatory tradition, its institutional culture, and the need for approval of investigative action from several bureaucratic layers made it much less effective in conducting any probe.

84. See *Five Areas Where DTI Was at Fault*, The Times (London), Dec. 20, 1989, at 26, col. 1 (discusses the independent investigation of DTI and the Barlow Clowes affair conducted by Sir Anthony Barrowclough, Parliamentary Ombudsman); *Incompetent and Evasive*, Fin. Times, Dec. 20, 1989, at 16; *The End of the Affair*, The Times (London), Dec. 20, 1989, at 15, col. 1.

85. Ashworth & Narbrough, *150m for Clowes Investors*, The Times (London), Dec. 20, 1989, at 23, col. 2. Investors who lost less than 50,000 pounds, the vast majority of whom were retired persons received 90% of their losses plus interest. Those who invested more received a lesser percentage according to a sliding scale.

Over the past few years the SIB has caught a number of questionable firms in its net in the process of authorization. This denial of the entry of fringe operations into the financial services sector is just as critical a means of prevention as is the effect of strict enforcement against investment businesses guilty of wrongdoing.

E. Compliance and Control Powers

1. Disqualification of Firms and Individuals

The SIB has the power to disqualify firms and individuals from the investment business. Central to the investor protection framework system is the requirement that no person can carry on an investment business unless authorized to do so or exempt from such authorization.⁸⁶ The justification for the system of authorization is that allowing only fit and proper persons to engage in investment businesses will be the most effective and cost efficient way to prevent investor abuse. The SIB's power to disqualify firms and individuals allows the SIB to control who is authorized to engage in investment businesses. The SIB can exercise its power both at the initial authorization stage, by a refusal to provide authorization, and later upon violation of certain provisions of the F.S.A., by issuing a disqualification directive. There are severe criminal and civil sanctions for operating an unauthorized investment business.⁸⁷

a. Authorization of Investment Business

While authorization may be obtained in different ways, the most important are through membership in an SRO recognized by the SIB,⁸⁸ To obtain authorization, an applicant must submit to a recognized body of the SIB a profile of the applicant's business and its board of directors and senior management, its financial condition and history including any disciplinary proceedings or convictions, compliance arrangements within the firm enabling the applicant to abide by SRO rules, and a business plan that includes a profile of its proposed customer base.

The Secretary of State required already existing investment businesses to apply to an SRO or the SIB by February 27, 1988. By April 29, 1988, all investment businesses had to be fully authorized or in receipt of interim authorization. Upon application, a firm would receive interim authorized status until its application had been approved or rejected by the relevant self-regulating organization. This meant that some firms subsequently found to be unfit could be engaged in investment business.

86. F.S.A., *supra* note 1, § 13.

87. Criminal sanctions include up to two years in jail. Civil sanctions include agreements being unenforceable and voidable at a court's discretion and the SIB right to seek injunctive and restitution orders. *Id.* §§ 4-6.

88. *Id.* § 15.

The authorization process worked as a disinfectant on the financial services sector. Over six thousand firms, mostly in the insurance area, commenced the authorization process only to disappear when further information was requested or firms were rejected.⁸⁹ Only a very few appealed their rejections. Relatively few firms were rejected after supplying additional information.⁹⁰ However, the authorization process did notify the recognized bodies that complaints had been lodged against certain firms and that individuals previously convicted of improper conduct were attempting to return to the industry.⁹¹ By June 30, 1988, 31,000 of the 35,000 investment businesses had been fully authorized.⁹²

The SIB can withdraw or suspend an authorization if a person is not fit or proper to carry on an investment business, or if an authorized person or firm has contravened the F.S.A. or any regulations pursuant to it, or has furnished false, inaccurate, or misleading information in purported compliance with any provision.⁹³ In such situations, the SIB must provide written notice of its intentions along with a statement of the reasons, dates, and notification of the right to have the matter referred to the Financial Services Tribunal (FST or Tribunal).⁹⁴

b. SIB Disqualification Actions Against Individuals

Most of the SIB's enforcement powers relate to firms, and individuals connected with those firms have residual liability.⁹⁵ However, for violations of the conduct of business provisions, the SIB can pursue individuals directly. If it appears that an individual is not a fit and proper person to be employed in an investment business, section 59 permits the SIB to make a disqualification direction. The individual named is then prohibited, without the SIB's consent, from employment in the financial services sector.

The purpose of the disqualification directive is to prevent dishonest participants in one kind of investment business from moving to another sector after disqualification by concealing his former misdeeds or identity. A register of authorized persons lists individuals against whom a disqualification direction is in force.⁹⁶ Such information is not open to public inspection unless the member of the public satisfies the Secretary of State that he has a good reason for seeking the information.⁹⁷ The SIB will release names of those on

89. Riley, *A Birthday for Security Rules*, *Fin. Times*, May 2, 1989, at 19, col. 1.

90. See Waters, *Firms Fail to Gain Authorization*, *Fin. Times*, Aug. 26, 1988, at 16, col. 2.

91. See *supra* pp. 26-28.

92. SIB ANNUAL REPORT 1988/89, *supra* note 6, at 47.

93. F.S.A., *supra* note 1, § 28.

94. *Id.* §§ 29, 31. Persons authorized in another EEC state have automatic authorization under § 31. However, their authorization may be suspended, withdrawn, and terminated in similar fashion except that the home supervisor will be contacted.

95. *Id.* § 202.

96. *Id.* § 102(1)(e).

97. *Id.* § 103(2)-(3).

the disqualification list to prospective employers upon receipt of a job applicant's national health number that matches a number on the list. There are, however, due process protections for such individuals. They must receive advance warning, the reasons for the action, and notification that the case may be referred to the FST.⁹⁸

2. *Public Statements as to Misconduct*

Another of the SIB's compliance and control powers is derived from that section 60. Under that section, the SIB can issue a public statement that a directly authorized firm or individual (as opposed to the firm's employees) has been guilty of violating the conduct of business or financial resource rules. The firm involved must be notified in advance and will receive all of the rights that accompany a disqualification direction. This is a very drastic penalty, as it may affect the firm in both its relations with the public and its reputation in the marketplace.

3. *Remedies for Impermissible Transactions*

a. *Injunctions*

One of the most effective and efficient enforcement remedies is the injunction. It is preventive in that it can prohibit future conduct or repetition of a breach of the rules. It can be used to protect investors before they are hurt. It allows the enforcement agency to move quickly — a rarity when the judicial process is involved. In addition, injunctive relief may be more cost efficient than other kinds of enforcement since it can be narrowly tailored to provide only the minimum necessary relief, and it may obviate the need for a full trial.⁹⁹

Injunctions may be used to force investment businesses to comply with the authorization requirement or with other regulations, such as the ban on cold calling,¹⁰⁰ the restrictions on advertising,¹⁰¹ the ban on the employment of prohibited persons,¹⁰² or a violation of the conduct of business rules.¹⁰³ One advantage of the injunction is that the prosecuting party need only meet the civil rather than the criminal burden of proof. A court must grant the injunction if there is a reasonable likelihood that a person will contravene a provision of the statute, or has already contravened it, and there is reasonable

98. In making a disqualification direction the SIB has broad discretion as to length of time, conditions, and scope, and it may vary such directives once issued. The employer must take reasonable care not to employ a disqualified person or he may be subject to civil enforcement proceedings or a private action for damages. *Id.* §§ 59(6), 62(1)(d).

99. See generally Note, *Developments in the Law: Injunctions*, 78 HARV. L. REV. 994, 996 (1965) ("The expanding role of the injunction is partly due to the attractiveness of so flexible a remedy in a modern society with expanding regulation of complex economic and social affairs.").

100. F.S.A., *supra* note 1, § 56.

101. *Id.* § 57.

102. *Id.* § 59.

103. *Id.* § 61(1).

likelihood that the contravention will be repeated. Failure to obey an injunction places the defendant in contempt of court, which can result in a criminal conviction.¹⁰⁴ It is also important to note that all sections relating to injunctions provide for other ancillary sanctions where appropriate. These include criminal penalties, unenforceability of contracts entered into by the sanctioned party, restitution, or damages.

Procedurally, the SIB can apply to a court to obtain an injunction or restitution order against a firm or individual who violates or is likely to violate provisions of the statute.¹⁰⁵ An injunction also may be obtained if there is a reasonable likelihood that a person will contravene the rules of one of the SROs of which the person is a member. However, the SIB cannot seek an injunction against an SRO member unless it appears that the SRO itself is unable or unwilling to take appropriate steps itself to restrain the individual.¹⁰⁶

b. Restitution Orders

In certain cases, including some situations in which the issuance of an injunction would be proper, a court may grant a restitution order upon application of the SIB.¹⁰⁷ Such orders will be granted if 1) the court is satisfied that a person has been conducting an investment business while unauthorized or has contravened other applicable statutory rules and regulations,¹⁰⁸ and 2) profits have accrued to that person, or one or more investors have suffered loss as a result of the contravention. The court may order the person concerned to pay into court the profits accrued or recover and pay into court a sum equivalent to the investors' losses or other adverse effects.¹⁰⁹

It is uncertain whether a restitution order would apply to an investor who suffered a loss as a result of advice, as opposed to one who entered into a transaction and as a result incurred a loss or adverse effect or generated a profit for the investment business. The statute uses the word "transactions".¹¹⁰ A court can also appoint a receiver to recover the profits or money or property involved.¹¹¹ The use of a restitution order does not affect the right of the investor to bring an action for damages. Restitution orders are a form of ancillary relief, which give courts added flexibility in enjoining and minimizing the impact of violations of the F.S.A.¹¹²

104. *Id.* § 6.

105. *Cf.* Securities Act of 1933 §§ 20(b), 21, 15 U.S.C.A. §§ 77(t)(b), 78(u)(d) (1988) (regarding the SEC's use of injunctive powers).

106. F.S.A., *supra* note 1, § 61(2).

107. *Id.* §§ 6, 61.

108. *See id.* §§ 47-56.

109. *Id.* §§ 6(4), 61(4).

110. *Morse & Walsh, supra* note 39, at ¶¶ 27-28.

111. F.S.A., *supra* note 1, § 61(4).

112. Compare the SEC's development of ancillary remedies, which is based on the general equitable powers of federal courts rather than based in statute. Farrand, *Ancillary Remedies in*

c. Voiding of Contracts

At common law, when a statute made a particular activity unlawful unless licensed, contracts entered into by the unlicensed individual were illegal and void. In the case of *Cope v. Rowlands*,¹¹³ the plaintiff was not a licensed broker as required by the City of London. The defense to an action on a contract entered into by the broker and the defendant was that the plaintiff-broker was not duly licensed, authorized, and empowered to act; therefore, the contract could not be enforced. The court held that when a contract which the plaintiff sought to enforce was expressly or impliedly forbidden by the common or statutory law, the court would not lend assistance to give the contract effect.¹¹⁴ In recent years, such decisions have become less favored as courts have sought to avoid the forfeiture and penalty implications of illegality by upholding contracts on the basis of public policy or statutory interpretation.¹¹⁵

The F.S.A., however, specifically provides for the unenforceability of contracts in several settings. Contracts entered into by individuals who are carrying on an investment business are voidable when the individuals are neither authorized to conduct such investment business nor exempt from authorization.¹¹⁶ The injured party can recover monetary damages or property paid or transferred by him under the agreement, together with any compensation for loss sustained as a result of having parted with the money. Parties may have agreed upon remedies, that is, liquidated damages.

The party seeking to enforce the contract may have a defense to an unenforceability claim if that party took all reasonable precautions and exercised due diligence as to authorization. The court could enforce the agreement if the person reasonably believed, upon entering into it, that he did not contravene section 3 or did not know that the agreement was made as a result of an action by a person in default.¹¹⁷ In such cases, the court would consider whether it was inequitable for the agreement to be enforced or for money or

SEC Civil Enforcement Suits, 89 HARV. L. REV. 1779, 1781 (1976); Dent, *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865 (1983).

113. *Cope v. Rowlands*, 150 Eng. Rep. 707 (1836).

114. *Id.* at 710.

115. See *Phoenix General Ins. Co. v. Administratia Asigurarilor de Stat*, 1 Q.B. 216, 2 All E.R. 152 (1988). In *Phoenix General* the plaintiffs were not authorized to sell a particular class of reinsurance contract. The defendants, reinsurers, argued that the contracts were unenforceable thereby depriving the insured of any recovery. Plaintiffs successfully argued that the illegality did not affect the whole of the transaction with the insured. Where a statute merely prohibited one body from entering into a contract without authority and imposed a penalty upon him if he did sell, it did not follow that the contract itself was impliedly prohibited so as to render it illegal and void. Whether or not the statute had that effect depended upon considerations of public policy and the mischief which the statute was designed to prevent, its language, scope and purposes, the consequences for the innocent party, and other relevant considerations. *But see* Davies, *Unauthorized Insurer Is Not Liable for Claims*, *Fin. Times*, June 21, 1989, at 14, col. 1.

116. F.S.A., *supra* note 1, § 5.

117. See *id.* § 5(3).

property transferred to be retained. When an agreement is unenforceable, the investor must return any money or property received.¹¹⁸

Other situations where investment agreements may be held unenforceable include those made pursuant to an unsolicited call or in violation of the cold calling regulations.¹¹⁹ Such contracts are unenforceable against the person on whom the call was made. That individual is entitled to restitution of money or property paid together with compensation for any loss sustained.¹²⁰ Agreements voidable under this section may be upheld if a court is satisfied that the person on whom the call was made was uninfluenced, or materially uninfluenced, by anything said during the call, or that the agreement entered into followed discussions other than the one during the call, and the person on whom the call was made was aware of the nature of the agreement and any risks involved in entering it.¹²¹

An agreement involving an unsolicited call would also be upheld if the call was not made by a person who would benefit as the result of such an agreement, for instance, someone benefiting only through a commission. The purpose of this section is to give the courts flexibility and to prevent an individual from using grounds of unenforceability to repudiate an agreement because some time later he changed his mind.¹²²

Unenforceability also applies to contraventions of the restrictions on advertising.¹²³ After use of an advertisement, the advertiser is not entitled to enforce any agreement relating to the that advertisement. Where an advertisement invites persons to exercise rights conferred by an investment (pre-emptive rights), the court may prevent enforcement of any obligation arising out of the exercise of such rights. The court may enforce agreements made after contraventions of advertising restrictions in the same circumstances that unsolicited call agreements can be enforced.¹²⁴

Contracts which are subject to unenforceability are voidable rather than void in their making.¹²⁵ The injured party can have restitution of any funds or property paid or, if the property has been transferred to a third party, the value of the property transferred. In addition, with the permission of the court, the injured party is entitled to recovery of expenses for loss sustained as a result of parting with the property, or money as a reliance measure of recovery. Unless the innocent party waives the unenforceability of the contract, he

118. *See id.* § 5(4).

119. *Id.* § 56(2).

120. *Id.* § 56(2)(b).

121. *Id.* § 56(4).

122. There is a fourteen day to twenty-eight day cancellation period for certain kinds of agreements such as life insurance policies. SIB, FINANCIAL SERVICES TRIBUNAL (CONDUCT OF INVESTIGATION) RULES 1988, at ch. V (1988) [hereinafter SIB CONDUCT OF INVESTIGATION RULES].

123. F.S.A., *supra* note 1, § 57.

124. Another situation to which the unenforceability doctrine applies is an insurance contract promoted in contravention of provisions restricting unauthorized insurance companies from selling insurance. *See id.* §§ 131-132.

125. *Id.* § 5(6).

is not entitled to benefits under the agreement and must return any property received under it.

The unenforceability provisions allow courts to shape a just and equitable response to violations of the statute. Ironically, there has been an absence of concern about these sanctions by the financial services industry in contrast to virtual paranoia over liabilities resulting from private actions for damages under section 62. It has been suggested that the meek reaction to unenforceability reflects recognition of the flexibility of the courts' powers.¹²⁶

d. Private Actions for Damages

In addition to direct enforcement actions available to the SIB, the F.S.A. provides for a private cause of action by individuals who suffer loss as a result of the violations of the F.S.A. or a contravention by a member of an SRO or other organized body of the rules of the organization to which it is a member.¹²⁷ Violators of the conduct of business rules or the SIB's enforcement powers are subject to civil suit.¹²⁸ The grant of a private right of action was the most controversial single provision in the statute.¹²⁹ Under the 1989 Companies Act amendments, the right to bring suit under the statute has been limited to investing members of the public in the United Kingdom, a most non-litigious group.¹³⁰

Under the American system, the use of the private right of action by investors complements governmental enforcement of securities laws.¹³¹ While American securities laws provide some express remedies,¹³² courts have found that Congress intended to give private parties implied rights of action for violations of many sections of the securities laws.¹³³ Because of the

126. Morse & Walsh, *supra* note 39, at ¶ 23.

127. F.S.A., *supra* note 1, § 62.

128. In addition to being available for violations of the conduct of business rules, private actions apply to breaches of restrictions on business or dealing with assets (§ 71(1)); violations of certain authorized unit trust provisions (§§ 91(4), 95); failure to furnish information as requested by the SIB (§§ 104(4), 178(5)); violation of certain provisions relating to the insurance business (§ 130(7)), banking business (§ 185(6)), and violation of the Rules of Friendly Societies (sched. 11(22)(4)); contraventions of prospectus rules, a false or misleading prospectus § 171(6), or breach of a DTI notice limiting a foreign power to conduct investment business in the U.K. (§ 185(6)).

129. Practitioners feared that complaint courts would make it an expansive remedy similar to the Securities and Exchange Commission's Rule 10b-5. See Morse & Walsh, *supra* note 39, at § 23.

130. Companies Act, ch. 40, § 193, 1989 (adding § 62A to the Financial Services Act).

131. See *J.I. Case v. Borak*, 377 U.S. 426 (1964).

132. E.g., Securities Act of 1933, §§ 11(a), 12(1), 12(2), 15 U.S.C.A. §§ 77k, 77l(1), (2) (1988) (misleading registration materials, failure to comply with prospectus requirements, material misstatements by sellers of securities); or Securities Exchange Act of 1934, §§ 9(3), 16(b), 18(a), 15 U.S.C.A. §§ 78(i), 78p(b), 78r(a) (1988) (manipulation of exchange listed securities, disgorgement of insider profits, material misstatements and omissions in SEC filings).

133. The most important being an implied right of action for violations of rule 10b-5 and §§ 10(b) and 14(a) of the Securities Exchange Act of 1934. *Herman & MacLean v. Huddleston*, 495 U.S. 375 (1983) (reaffirming implied of action under § 10b and rule 10b-5); *J.I. Case v. Borak*, 377 U.S. at 438.

ambiguities in the legislative history of the American securities acts, the issue of whether private plaintiffs have a right of action for violation of a particular section of the securities acts has been a subject of ongoing judicial interpretation.¹³⁴ The lower courts were particularly responsive to the expansion of private rights of action, and this has had a multiplier effect upon the overall enforcement effort.

Though rights of action for damages are more explicit in the F.S.A., it is doubtful that private litigation will play nearly as important a role in the English system. The limitations on contingent fees for attorneys,¹³⁵ the weight of interest groups against the private right of action, and the absence of a plaintiff's bar make its use uncertain.

4. Powers of Intervention

The SIB has the power to enforce the provisions of the F.S.A. by intervening in the business activity of a firm.¹³⁶ While a regulatory body should act as quickly as possible when an investment firm has violated the rules, it may be preferable for the body to use the minimum enforcement power necessary to correct the wrong and protect innocent people. A revocation of authorization would destroy the firm's ongoing business value and result in its liquidation. The SIB is authorized to intervene against directly authorized or automatically authorized businesses when it is desirable for the protection of investors, when the firm involved is unfit to carry on investment business of a particular kind or to the extent proposed, or when the authorized person has committed a breach of the statute or regulations or has furnished false or misleading information in purported compliance with the statute.¹³⁷

Essentially, intervention permits the SIB or its appointed representative to intercede and run an investment business. The SIB can assume the normal powers of a board of directors. The intervention powers are analogous to American state corporate statutes, such as that of Delaware, which permit the appointment of a custodian as an alternative to dissolution.¹³⁸ However, the Delaware statute requires application to the Court of Chancery before

134. In *Huddleston*, 459 U.S. 375, the Supreme Court upheld a private plaintiff's right of action. However, the standard of proof is now a preponderance of the evidence standard. See *Blue Chip Stamps v. Manor Drugs*, 421 U.S. 723 (1975); see generally HAZEN, *THE LAW OF SECURITIES REGULATION* § 13.1 (2d ed. 1990).

135. In 1989, the British government proposed reform of the legal profession that would permit contingent fees. Attorneys would be able to charge at a higher rate than normal, but the maximum amount by which a lawyer's fee could be increased would be limited by the Lord Chancellor. LORD HIGH CHANCELLOR, *LEGAL SERVICES: A FRAMEWORK FOR THE FUTURE* 41 (1989). This reform will not open the litigation floodgates, however, as the losing party will still be required to pay the reasonable costs of his successful opponent, which is a deterrent to plaintiff. This will lead lawyers to conduct a more rigorous assessment of the profits and chances for success than in the United States. In addition, class actions would not be brought, discouraging strike or frivolous suits. LORD CHANCELLOR'S DEPT., *CONTINGENCY FEES* 6-7 (1989).

136. F.S.A., *supra* note 1, §§ 64-71.

137. *Id.* § 64.

138. DEL. CODE ANN. tit. 8, § 226(a) (1953).

such powers are granted, whereas under the F.S.A. the SIB can exercise such power merely if it appears to be desirable for the protection of investors.¹³⁹ Intervention is a remedy that can be used without resorting to the courts and will not destroy a business as would revocation of authorization.

The power of intervention is unavailable against a member firm of an SRO or other recognized body, except that the SIB can require the transfer of investors' assets to an approved trustee if requested by the recognized body.¹⁴⁰ Section 65 allows prohibition of an authorized person from entering into certain transactions except in specified circumstances or to a prescribed extent. The SIB also can limit the solicitation of business to certain persons or can restrict the conduct of business.

A second type of intervention power available to the SIB is a restriction on dealing with assets, by which the SIB may prohibit an authorized person or appointed representative from disposing of or otherwise dealing with any assets or specified assets, including those located outside of the United Kingdom.¹⁴¹ The SIB also has the power to vest in a trustee the assets belonging to an authorized person, an appointed representative, or investors.¹⁴² Finally, the SIB may intervene by requiring an authorized person or appointed representative to maintain within the United Kingdom assets of such value "as appears to the Secretary of State to be desirable with a view to insuring that the authorized person or, as the case may be, appointed representative, will be able to meet his liabilities in respect of investment business."¹⁴³

Before these intervention powers are implemented, the SIB has to provide written notice and give particulars of the firm's right to referral of the matter to the Financial Services Tribunal. Breaching a prohibition or requirement imposed under the intervention powers can lead to public statements as to misconduct, injunctions, restitution orders, and sanctions for damages.¹⁴⁴ From 1988 to 1990, the SIB used its intervention powers seventeen times. In ten of these instances, the SIB intervened to restrict an authorized business or firm from entering into a particular kind of investment business.¹⁴⁵

5. *Winding Up*

When fraud is uncovered, there are usually insufficient assets to pay the accumulated debts. The SIB can petition a court having jurisdiction under the Insolvency Act of 1986¹⁴⁶ to liquidate an authorized person or firm if that person or firm is unable to pay his debts, or if the court is of the opinion that

139. F.S.A., *supra* note 1, § 64(1)(a).

140. *Id.* § 64(4).

141. *Id.* § 66.

142. *Id.* § 67(1).

143. *Id.* § 68.

144. *See id.* § 71.

145. SIB ANNUAL REPORT 1989/90, *supra* note 6, at 23.

146. F.S.A., *supra* note 1, § 72.

a liquidation would be just and equitable.¹⁴⁷ This section would apply to a firm authorized and regulated by a recognized body, if that body gives consent.

The liquidating power enables the SIB to use the Insolvency Act procedure without having to rely on a creditor's petition. Using the ability to pay debts as a ground for liquidation prevents further harm to creditors or investors. An authorized person who defaults on an obligation to pay any sum due and payable under any investment agreement is deemed to be unable to pay his debts.¹⁴⁸ A just and equitable ground for a winding up order is also available where the authorized person's main business has disappeared or the company was formed for a fraudulent purpose.¹⁴⁹

Under section 74, the SIB may present a petition under section 9 of the Insolvency Act for the appointment of an administrator when a directly or automatically authorized person or member of a recognized body of the company is unable to pay their debts.¹⁵⁰

6. *Compliance and Control Powers Over Recognized Bodies*

The SROs, professional bodies, investment exchanges, and clearing-houses must be "recognized" by the SIB. Recognition is granted if the organization meets requirements for recognition as outlined in the statute.¹⁵¹ The "recognized body" is responsible for ongoing supervision of member persons and firms.

In a self-regulatory system, the effectiveness of enforcement efforts depends upon the ardor of the private regulating bodies in monitoring and disciplining their members. One argument in favor of practitioner-based regulation is that members of the affected industry can bring to bear their expertise.¹⁵² Informed practitioners are closer to regulatory problems and may be better able to solve them.¹⁵³ Practitioner-based regulation is more likely to receive the support of the regulated because of the regulators' familiarity with industry problems.

147. *Id.* § 72.

148. *Id.* § 72(3).

149. Morse & Walsh, *supra* note 39, at ¶¶ 268-71.

150. This procedure is somewhat analogous to a Chapter XI proceeding under the Federal Bankruptcy Act. Bankruptcy Act of 1978, 11 U.S.C. §§ 1101-1112.

151. F.S.A., *supra* note 1, §§ 9-10, 16, 17, 36-39, scheds. 2-4. The requirements for recognition include: the members of the body to be recognized have to be fit and proper persons, the organization have fair and reasonable rules for admission, expulsion and discipline, have safeguards for investors, have adequate arrangements for monitoring and enforcement of compliance with its rules, have members of the public on its governing body, have the capacity to investigate complaints and promote high standards in the carrying on of investment business by its members. *Id.* sched. 2.

152. SECURITIES AND EXCHANGE COMMISSION, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 95, 88th Cong., 1st Sess., pt. 4, at 722 (1963) [hereinafter SPECIAL STUDY].

153. Karmel, *Securities Industry Self-Regulation — Tested by the Crash*, 45 WASH. & LEE L. REV. 1297, 1306 (1988).

Despite these advantages to practitioner-based regulation, there are countervailing pressures which may turn self-regulatory bodies into self-protecting industry trade associations. Self-regulating organizations have public responsibilities without a governmental agency's accountability to the public. All too often, self-regulation becomes self-protection. SROs may emphasize their trade association functions and attempt to restrict competition. The first criticism of self-regulatory enforcement is a lack of zeal. In this context, the SIB's supervision and ability to sanction recognized self-regulatory bodies becomes critical in ensuring that enforcement and regulatory intensity will exist at the SRO level.¹⁵⁴

The SIB has three sanctions against recognized bodies: revocation of recognition, application to a court for a compliance order, and alteration of the recognized body's rules. Revocation of recognition is the SIB's equivalent to capital punishment. Theoretically, it may be used if any of the requirements for recognition are violated, if the recognized organization has failed to comply with any obligations to which it is subject under the act, or if continued recognition of the organization is undesirable, with regard to the existence of one or more other recognized organizations.¹⁵⁵ This last factor, undesirability of continuing recognition, is the only conceivable situation where recognition might actually be revoked. For example, if an SRO or other recognized body merged, dissolved, or had its functions assumed by an existing recognized body with the approval of the SIB, its recognition might be revoked.¹⁵⁶

A less drastic sanction is the compliance order, whereby the SIB can apply to the High Court or the Court of Session if an SRO has failed to comply with any obligations under the act or has violated a requirement for recognition.¹⁵⁷ The court may order the recognized body to take such steps as it directs to cure the breach or violation. If the rules of a recognized body, such as its conduct of business rules,¹⁵⁸ do not satisfy required investor protection safeguards, the SIB can direct the organization to alter the rules or it may alter the SRO's rules itself in such manner as is necessary.¹⁵⁹ Before making such direction, the SIB normally must consult with the organization. The SRO has the right to apply to the High Court or Court of Session to have the alteration set aside.

154. See Miller, *Self-Regulation of the Securities Markets: A Critical Examination*, 42 WASH. & LEE L. REV. 853 (1985) (providing a critical view of the U.S. experience with self-regulation).

155. F.S.A., *supra* note 1, § 11(1).

156. See Conclusion *infra* pp. 144-52.

157. F.S.A., *supra* note 1, § 12.

158. *Id.* at sched. 2(3)(1).

159. *Id.* § 13. The rule amendment capability is enforceable by mandamus in England or specific performance in Scotland.

III.

THE LIMITS OF ADMINISTRATIVE POWER

The F.S.A. gives the SIB, and in turn the recognized bodies, expansive powers to take investigatory and enforcement actions against individuals and firms. As noted above, the effectiveness of enforcement depends on the scope of these powers. However, the fairness of the investor protection system should also be considered.

Generally, fairness is a function of the limits that are placed upon the exercise of power. These limits fall into two categories. The first are the statutorily defined boundaries to enforcement powers. The second are the procedural limitations which provide protection to persons subject to enforcement actions. These procedural limitations are the subject of the next section.

Self-regulating organizations have a number of conflicting responsibilities. They are expected to set standards and discipline their members so that investors will be protected. Private self-regulating organizations serve public purposes and, in fact, assume public and governmental responsibilities. Their power to set standards and to mandate how business is conducted, to discipline, restrict entry, and to expel is in reality a delegation of state power to private bodies. This power can provide the opportunity for abuses of authority¹⁶⁰. Penalties to violators of rules may be draconian or inadequate. In addition, standard forms of governmental or judicial accountability may be absent.

A. *Due Process Requirements*

Self-regulatory systems often have been criticized for the lack of fairness in their procedures. Private organizations may act arbitrarily against non-members or those seeking entry. To protect against this, there are requirements throughout the F.S.A. that the self-regulating bodies act with fairness and afford due process.

The requirement of due process means that when an individual's rights or interests are affected by administrative action, certain minimal procedures must be granted. At the least, the fact finder must be impartial. No party should have a decision rendered against him unless he has been given proper notice of the claim against him and a reasonable opportunity to be heard. In English law, the phrase used is that interests affected by administrative actions are protected under principles of "natural justice."¹⁶¹ Nor can an administrative body exceed the powers granted to it.¹⁶²

160. See generally Lowenfels, *A Lack of Fair Procedures in the Administrative Process: Disciplinary Proceedings at the Stock Exchanges and the NASD*, 64 CORNELL L. REV. 375 (1979); Poser, *Reply to Lowenfels*, 64 CORNELL L. REV. 402 (1979).

161. *Regina v. Panel on Takeovers and Mergers ex parte Datafin*, 1 All E.R. 564 (C.A. 1987).

162. *Morse & Walsh*, *supra* note 39, at ¶¶ 1313-15.

To counteract the dangers of abuse of authority against investment businesses or those seeking entry into the financial services industry, fairness and process blanket the statute. The F.S.A. requires both the SIB and recognized bodies to have reasonable rules and an independent procedure for appeals relating to the admission, expulsion, and discipline of members.¹⁶³

The concern that there be adequate process, that individuals, firms, and recognized bodies are protected is reflected throughout the self-regulatory system. This is somewhat of a break from the past, for the English approach traditionally has been to devise methods of regulation which operate along less formalized lines than in other countries, with less emphasis on statutory protections which are found in the American system. The elements of due process in the self-regulatory system established under the F.S.A. include proper notice of the claim against the charged, a reasonable opportunity to be heard, an impartial fact finder, an absence of arbitrary decisionmaking, and a right of appeal.

A distinction between English and American administrative law requirements is that the investor protection framework does not explicitly give those charged the right of representation by an attorney, though in practice this nearly always occurs.¹⁶⁴ The F.S.A. provides avenues of appeal for most actions against a member by a recognized body. In addition, common law developments have limited the arbitrariness of private agency action.

Perhaps the most important enforcement power of a recognized body or the SIB is its control of entry into the regulated area both in terms of authorization and disqualification. If a firm seeks direct authorization and the SIB proposes to refuse such application or to withdraw or suspend an authorization granted, it must give the applicant or authorized person written notice of the intention to do so, giving the reasons for which it proposes to act.¹⁶⁵ In the case of a proposed withdrawal or suspension, the notice shall state the date on which it is proposed that the withdrawal or suspension should take effect, and in the case of a proposed suspension, its proposed duration.¹⁶⁶ If the reasons stated in the notice include comments about another person and are prejudicial to that person, his office, or employment, a copy of that notice will be sent to the other person.¹⁶⁷ Where the SIB intends to terminate or suspend authorization, notice must be given of intention to do so, stating the reasons for which it proposes to act and notice of the right to have the matter referred to the Financial Services Tribunal.¹⁶⁸

163. F.S.A., *supra* note 1, sched. (2)2. "The rules and practices of the [self-regulating] organization relating to (a) the admission and expulsion of members; and (b) the discipline it exercises over its members, must be fair and reasonable and include adequate provision for appeals." Sched. 3, 4(5) applies such standards to recognized professional bodies.

164. See Morse & Walsh, *supra* note 39, at ¶¶ 1401-03.

165. F.S.A., *supra* note 1, § 29(1).

166. *Id.* § 29(2).

167. *Id.* § 60.

168. See *id.* § 96(3)-(4). Schedule 6 concerns the terms of office of Tribunal members, their expenses, Tribunal staff, procedures, appeals, and supervision by the Council of Tribunals. The

Intervention powers generally require the SIB to give the person or applicant written notice of the intention to take action, stating the reasons for which the SIB proposes to act, and giving particulars of the right to require the matter to be referred to the FST. In seeking traditional civil remedies, such as an injunction or restitution order, application is made to a regular court, and full due process procedures would apply there.

The recognized bodies have equivalent due process provisions. Each has built into its procedures an adjudicative panel plus an appeals tribunal.¹⁶⁹ To protect the public from arbitrariness and self-interested decisions, each recognized body must include on its board a number of persons independent of the organization and its members so as to achieve a proper balance between the interests of the membership, the interests of the organization, and the interests of the public. Board members, however, have a limited role in the day-to-day application of the rules.¹⁷⁰

If the recognized body has failed to comply with the statutory obligations, or if another SRO is regulating the same business, the SIB can revoke recognition.¹⁷¹ The notice provided by the SIB must inform the recognized organization that it is required to bring such notice of revocation to the attention of the members of the SRO or recognized body and to publish it in such a way as to bring it to the attention of other persons affected. The notice provided by the SIB to the recognized body must state the reasons for which the SIB proposes to act and give the particulars of the rights of the recognized body.¹⁷² The recognized body then has three months to make written or oral representations to the SIB or to a person appointed to hear the representations in determining whether to revoke the recognition order. There is no appeal, however, to the FST.

B. The Financial Services Tribunal

The FST, established under the Financial Services Act, has the responsibility of investigating cases referred to it and reporting on these matters to the SIB.¹⁷³ Unlike the rest of the self-regulating system, the Tribunal is an independent body paid for by public funds. Its powers are not transferrable to the SIB.¹⁷⁴

Secretary of State has made rules on the Tribunal's procedure. The SIB CONDUCT OF INVESTIGATION RULES, *supra* note 122, came into force on March 24, 1988.

169. "Any party to proceedings before the Financial Services Tribunal who is dissatisfied may bring an appeal on a point of law to the High Court or require the Financial Services Tribunal to state and sign a case for the opinion of the High Court." Tribunals and Inquiries Act of 1971, § 13, *as amended by* F.S.A., *supra* note 1, § 96(6), sched. 6, ¶ 6.

170. Board members of the SIB and SROs are representatives of the industry who work full time for a financial services firm or public members unaffiliated with the financial services industry. F.S.A., *supra* note 1, sched. 2, ¶ 5(1)(b).

171. *Id.* § 11.

172. SIB CONDUCT OF INVESTIGATION RULES, *supra* note 122, rule 4.

173. F.S.A., *supra* note 1, § 98.

174. *Id.* §§ 27, 33, 60, 64, 79, 91.

Members of the FST are drawn from a panel of not less than ten. The panel consists of persons with legal qualifications who are appointed by the Lord Chancellor after consultation with the Lord Advocate, as well as individuals appointed by the Secretary of State, who appear to him to be qualified by experience or otherwise to deal with the types of cases that may be referred to the FST.¹⁷⁵

When a case is referred to the FST, the Secretary of State nominates three persons from the panel to serve as members, one of whom serves as Chair. The Chair must have legal qualifications, and one of the other members of the panel should have practical experience.¹⁷⁶

When an individual receives a notice about a matter relating to the SIB's enforcement and disciplinary powers, he can require the SIB to refer the matter to the Tribunal.¹⁷⁷ So that charges will not linger, the statute of limitations is twenty-eight days from the service date of the notice. There is also an expedited process requiring the SIB to transmit information more quickly.¹⁷⁸ Strict time limits require prompt reports of FST deliberations.¹⁷⁹

Where referral has been required by a person on whom notice is served, the FST must investigate the case and make a report to the SIB stating what would, in its opinion, be the appropriate decision in the matter, and reasons for that decision.¹⁸⁰ Where the matter referred deals with the refusal of an application for authorization, the FST may report that the appropriate decision would be to grant or to refuse the application, or, in the case of an application for the rescission of a prohibition or requirement of authorization, to vary the prohibition or requirement in a specified manner.¹⁸¹

Where a matter referred to the FST is anything other than the refusal of authorization, the Tribunal may report that the appropriate decision should be: (1) to take or not take the action taken or proposed by the SIB; (2) to take any other action that the SIB could take under the provision in question; or (3) to take any action within the power of the SIB under the F.T.A.'s provisions, such as withdrawal or suspension of direct authorization, termination or suspension of a Europerson's application, publication of a statement as to a person's misconduct, or any of the SIB's powers of intervention.¹⁸² There are detailed evidentiary rules for testimony before the Tribunal.¹⁸³ Any party to a proceeding before the FST may appeal on a point of law to the High

175. *Id.* § 96(2).

176. *See supra* note 169.

177. F.S.A., *supra* note 1, § 97.

178. SIB CONDUCT OF INVESTIGATION RULES, *supra* note 122, rule 4.

179. *See id.* rule 16(1).

180. F.S.A., *supra* note 1, § 98(1).

181. *Id.* § 98(2).

182. *Id.* § 98(3)-(4).

183. Evidence may be taken orally or in writing. There is a right to counsel at Tribunal hearings. All participants have the right to receive transcripts of all oral evidence. All parties have an opportunity of inspecting the evidence and taking copies. The Financial Services Tribunal has subpoena powers. Evidence is given on oath. SIB Rules, *supra* note 122.

Court.¹⁸⁴ However, FST decisions are normally final. The SIB has the power to publish the FST report if it sees fit.

Each of the SROs has analogous procedural arrangements to hear appeals from refusals of authorization or for disciplinary matters and to provide appellate review of that decision.¹⁸⁵ The SIB itself does not hear appeals from such SRO decisions. A person refused admission or expelled from an SRO may apply for direct authorization or attempt to gain standing before a regular court. However, the FST does not hear complaints of investors.

C. Access to Judicial Review

After consideration by the FST, there may be review by a regular court under narrowly defined circumstances. The F.S.A. vests certain powers in the Secretary of State who can then delegate those powers to a designated body, which can recognize self-regulating bodies to carry out some of the purposes of the legislation.¹⁸⁶ In exercising its authority to make rules and regulations, the SIB, as with more traditional administrative agencies, must follow the principles of public law and is subject to judicial review.¹⁸⁷ The SIB cannot exceed the powers granted to it by the statute, exercise its rules in an unfair or arbitrary way, fail to follow its rules, excessively misinterpret the law (so as to take its authority outside its jurisdiction), or fail to provide a fair hearing.¹⁸⁸

The first legal decision involving the SIB's investigatory and enforcement powers occurred in March 1989 in the case of *Securities and Investment Board v. Pantell*.¹⁸⁹ Pantell, a Swiss company, mailed from abroad advertisements of its services to individuals in the United Kingdom. The advertisements offered investment advice, stressed the impartiality of that advice, and recommended shares in a U.S. company, Euramco, characterized as "the share of 1988." The shares were said to be publicly owned and traded. In fact, Euramco was neither listed nor traded on any stock exchange. One of Pantell's directors was the president of the touted company.¹⁹⁰ Furthermore, it would have been illegal for a U.S. dealer to trade in Euramco's shares which had been issued in Europe.¹⁹¹

184. F.S.A., *supra* note 1, sched. 6(6).

185. See, e.g., FINANCIAL INTERMEDIARIES, MANAGERS AND BROKERS REGULATORY ASSOCIATION RULES, Rule 19 (1989) [hereinafter FIMBRA RULES].

186. F.S.A., *supra* note 1, §§ 101, 114, 116.

187. Morse & Walsh, *supra* note 39, at ¶ 1423.

188. *Id.* at ¶¶ 1311-1430.

189. 3 W.L.R. 698 (Ch. 1989).

190. *Id.* at 699.

191. The SIB had been in contact with Swiss authorities about Pantell since December 1988. On Tuesday, March 7, the public prosecutor in Lugano informed the SIB that it had commenced action to close down Pantell on grounds of violations of Swiss banking law, the law of fiduciary firms, swindling, breaches of banking and saving laws, and the obligations of fiduciaries. Seized records indicated that Pantell largely had conducted business with U.K. investors. The company

Following the conversation with the Swiss public prosecutor, the SIB sought approval from the SIB Board to institute a statutory investigation into the affairs of Pantell and any account it had with Barclays Bank. SIB staff were appointed to investigate on the same day Board approval was received.¹⁹² The SIB sought to freeze all of Pantell's funds. The legal issue before the court was whether, by sending circular advertisements from outside the United Kingdom to persons within, Pantell was carrying on investment business within the United Kingdom. If so, Pantell was liable for violating several sections of the F.S.A.¹⁹³ Another issue was whether the SIB had standing to seek an injunction restraining the distribution of assets even though it had no private right of action. In other words, the SIB itself had no beneficial interest in the money obtained from U.K. investors.

The court found that the designated agency had the right to obtain an order from the court either under section 6 or 61, because Pantell had been carrying on an investment business in contravention of the authorization section,¹⁹⁴ and the SIB had the right to require Pantell to pay a sum of money to the SIB or otherwise to secure Pantell's profits. Sums paid in or otherwise secured would then be available for distribution to the hapless investors.¹⁹⁵ The court concluded that section 61 conferred on the SIB powers similar to section 6 to curb unauthorized advertisements. Parliament, by giving the Secretary of State and delegating to the SIB a statutory cause of action, invested it with the necessary standing to apply for injunctive relief.¹⁹⁶

Pantell demonstrated that the SIB could act quickly and effectively, and that courts would define the designated agency's authority and the definition of "investment business" expansively. This was in contrast to the response of courts to the DTI's and the SFO's efforts to expand the crime of insider dealing.

In recent years, English courts have taken an expansive view as to what activities of private bodies will be subject to judicial review. This doctrine first saw light in the financial services area in *Regina v. Panel on Takeovers & Mergers ex parte Datafin*.¹⁹⁷ The Panel on Takeovers and Mergers, a self-regulatory unincorporated association, administers the City Code on Takeovers and Mergers, a code of conduct to be observed in tender offers of listed public companies.¹⁹⁸ The Panel has no direct statutory, common law, or contractual powers over the City, but has been supported by certain statutory

had sent checks from British investors to a Barclays Bank branch in London, which had instructions to transfer funds received into an account of a connected corporation in Guernsey. *Id.* at 700.

192. *Id.*

193. *Id.* at 701.

194. F.S.A., *supra* note 1, § 3.

195. *Pantell*, 3 W.L.R. at 702-703.

196. *Id.* at 703.

197. 1 All E.R. 564 (C.A. 1987).

198. *See id.* at 564.

powers and the consensus of the City establishment. In the course of a takeover, Datafin, a tender offeror, unsuccessfully complained to the Panel that other contestants for the target company had acted in concert in violation of the City Code. Datafin then sought judicial review of the Panel's decision, which the lower court denied.

The Court of Appeal, however, concluded that if the responsibility imposed on a private body was a public duty, and the body was exercising public functions, a court had jurisdiction to entertain an application for judicial review of that body's decisions. Given the importance of the matters regulated by the City Code and the consequences of noncompliance, the Panel was performing such a public duty and its actions were thus subject to review. However, the court would meet the need for speed in the context of a takeover and grant review only in those cases where there had been a breach of natural justice. Courts would defer to the Panel's interpretation of its rules and only intervene sparingly in Panel decisions.

In a later case, Guinness, as offeror, made a successful tender offer.¹⁹⁹ The Panel decided Guinness had infringed the City Code and decided not to adjourn its ruling on the violation pending completion of a DTI inquiry. Guinness sought judicial review of the refusal to adjourn the ruling. The High Court said that although the panel had been lacking in consideration in refusing a limited adjournment, it was not a breach of natural justice. The court denied the application.

Datafin and *Guinness* suggest that while private self-regulating bodies are subject to review, courts will not allow themselves to be used, as is the American custom, as one more arrow in the quiver of tender offer tactics. The courts will not be a tool of delay in the takeover process. In accord with *Datafin*, a court has held that an SRO also has public duties and is subject to judicial review.²⁰⁰ One can surmise that courts will be no more favorable to applications for review from recognized body appeals tribunals than from the Panel.²⁰¹

Only recently have the SRO appeals tribunals started hearing cases. There are some aspects of SRO procedures which may attract a court's interest. The SROs have a more informal approach to the rules of evidence, and there is no right to counsel. In a wide departure from normal due process procedures, FIMBRA rules provide that its appeals tribunal is entitled to act on confidential information and documents without disclosing them or their source to parties.²⁰² This violates the cardinal principle of confrontation with

199. *Regina v. Panel on Takeovers & Mergers ex parte Guinness*, 1 All E.R. 509 (C.A. 1988).

200. *Bank of Scotland v. IMRO*, 1989 Sess. Cas. 700. Section 200 of the Companies Act, 1989, ch. 40 *amending* F.S.A. § 188 grants jurisdiction for proceedings arising out of any act or omission of a recognized SRO or the SIB in the discharge of its function to the High Court or the Court of Session.

201. *Morse & Walsh*, *supra* note 39, at ¶¶ 1427-30.

202. FIMBRA RULES, *supra* note 185, rule 19.4.4.

one's accusers. IMRO provides that in appeals relating to authorization, confidential information need not be shown to the applicant but the applicant must be given sufficient information to rebut the confidential information.²⁰³ On the other hand, a criticism by staff of The Securities Association's appeal tribunal has been that its procedures have become too legalistic and formal.²⁰⁴ One can predict that this trend will continue as part of the overall legalization of financial services procedures.

IV.

PROSECUTION OF SECURITIES FRAUD AND INSIDER DEALING

Several factors led to the introduction of the new investor protection framework, but perhaps the most important was the inability of the existing self-regulatory bodies²⁰⁵ and the DTI to deal with fraud, insider dealing, and market manipulation. Fraud had always been present, but such misdeeds, when uncovered, were handled quietly by the City within the particular institution or firm affected, or in extreme situations by the Bank of England.²⁰⁶ There was neither public nor Parliamentary interest in such matters. The perception of the City as a bastion of integrity where one's word was one's bond was accepted by successive governments and enabled the Stock Exchange and other financial institutions to retain complete freedom of operation.

In the post-World War II period, new markets such as Eurobonds and fresh opportunities brought with them different kinds of risk and methods of doing business and created new ethics and norms of responsibility. Throughout the 1980s, there was a series of scandals affecting the banking system, Lloyds of London, commodities markets, and the Stock Exchange. These incidents occurred in a societal, cultural, and regulatory milieu quite different from the past.²⁰⁷ There was in depth coverage by the press. The public was involved at least indirectly, for broad institutional ownership of securities by pension funds, investment and unit trusts represented the savings of millions of people. The fund managers had a fiduciary duty to the beneficiaries of these funds and trusts to ensure their savings were invested safely. If the financial markets were dishonest, the funds would have to be invested elsewhere, such as the United States.

The government was aware of this and desired to maintain London's prominence as a financial center. It also wished to encourage increased share ownership amongst the public. It believed, correctly, that to achieve these

203. INVESTMENT MANAGEMENT REGULATORY ORGANIZATION RULES (1989) ch. IX, rule 3.01 [hereinafter IMRO RULES].

204. Confidential interview.

205. These were primarily the London Stock Exchange, Lloyds of London, and the Take-over Panel.

206. See M. CLARKE, *REGULATING THE CITY* 4-6 (1986).

207. For a discussion of these scandals, see *id.* at 45-49, 62-83, 102-118.

goals it had to create a widespread confidence in the integrity of the marketplace. The F.S.A. was the result.

While the F.S.A. created new institutions to regulate those entering the financial services industry and devices to ensure ongoing monitoring of investment activity, it left virtually untouched the mechanisms of prosecution. The framework was engrafted upon an existing, ineffective system.

Perhaps unfairly, the investor protection system is judged only by the effectiveness of the prosecution of securities violators. Yet, effective prosecution and enforcement is not only an important deterrent to crime, it sets the tone for investor confidence in the financial markets and the image of the whole investor protection framework. The following sections outline the enforcement scheme with respect to fraud, insider dealing, and market manipulation.

A. Securities Fraud

The inability of British authorities successfully to uncover and prosecute commercial and securities fraud has long been notorious. The prosecutorial structure has been altered and reorganized under the new framework of investor protection with little apparent result. Criticism of the effectiveness of enforcement remains widespread. The lack of success of the British authorities in prosecuting financial fraud undermined Parliamentary and public confidence in the old self-regulatory system. The government established a Fraud Trials Committee, which is known as the Roskill Committee,²⁰⁸ to examine the difficulties in prosecuting commercial fraud and to offer recommendations for reform. The Committee concluded that the public no longer believed that the legal system was capable of successfully prosecuting serious frauds and added that the public perception was correct. The Committee's Report stated that at every stage, during investigation, preparation, commitment, pretrial review, and trial, the arrangements offered an open invitation to abuse and delay, and that the largest and most cleverly executed crimes escaped unpunished.²⁰⁹ It suggested fundamental change in the law, in prosecutorial procedures and in attitudes towards commercial crimes.

Many reasons exist for these enforcement problems, not the least of which are the difficulties inherent in the prosecution of securities fraud. First, such schemes are usually sophisticated, complex, difficult to unravel, international, and are often discovered only after the fact, when the money—and occasionally the perpetrators—have long disappeared. Investigation of fraud is labor intensive, time consuming, and burdensome on the understaffed and underfunded investigatory bodies, who may face the formidable task of examining thousands of documents in different venues.

208. The official title of the committee is the Fraud Trials Committee. It was named the Roskill Committee for its chair, Lord Roskill.

209. FRAUD TRIALS (ROSKILL) COMMITTEE REPORT 1 (1986) [hereinafter ROSKILL REPORT].

Second, English law enforcement is plagued by a number of overlapping, competing organizations, lacking coordination or shared purpose. Third, there is neither an enforcement tradition nor the widespread expertise necessary to prosecute commercial fraud. A fourth, more amorphous reason, is attitudinal. In the words of Professor Michael Levi, a researcher of commercial fraud, "There is no political mileage in being a high-profile fraud buster in this country, the tradition of discretion and caution is too deeply engrained."²¹⁰

"Criminal prosecution is the sharp end of the system of control of financial institutions, the ultimate sanction for the serious wrongdoer."²¹¹ Though it may be small satisfaction to defrauded investors, incarcerating perpetrators of financial misdeeds serves an important deterrence to future violators. The certainty of enforcement and prison for white collar criminals is an effective deterrence.

One cause of ineffective enforcement is that several separate bodies are concerned with the pursuit of fraud. Some investigate, others prosecute, while the Inland Revenue Department combines both functions. This has hindered expeditious and economical disposal of criminal fraud proceedings.²¹² Fraud complaints come from several sources. Information may be passed from one of the self-regulating bodies. The DTI may receive complaints from the public as might the Director of Public Prosecutions (DPP). Normally, commercial fraud cases are referred to the Crown Prosecution Service, headed by the DPP.²¹³ Insider trading and other financial frauds are prosecuted by the DPP, who is a public official, answerable to the Attorney General. The DPP must institute criminal proceedings in any case in which the importance or difficulty of the issues makes it appear appropriate to the DPP that he should institute the action.²¹⁴ However, that office has failed to mount aggressive and successful prosecutions.

In 1981 the DPP, the DTI, and the Metropolitan Police established the Fraud Investigation Group (FIG).²¹⁵ The FIG's function was to coordinate inquiries in major fraud cases at an early stage so as to increase the levels of cooperation between the police, the DTI, and the DPP. Despite the attempt to create a specialized group to handle major fraud cases, the police retained their independence, and the Inland Revenue and Customs and Excise Departments remain outside the FIG's jurisdiction.²¹⁶ Although one of the objectives of the FIG was to harness the various statutory powers available to the police, the DPP, and the DTI, most of the relevant powers remained the

210. Wolman, *Police Gain Partners in Fight Against Fraud*, *Fin. Times*, July 20, 1987, at 32, col. 1.

211. M. CLARKE, *supra* note 206, at 162.

212. See ROSKILL REPORT, *supra* note 209, § 2.1.

213. Prosecution of Offences Act, 1985, ch. 23, pt. I.

214. *Id.* § 3(2)(b).

215. In July 1984 the Fraud Information Groups were placed on a permanent basis.

216. ROSKILL REPORT, *supra* note 209, § 2.25.

exclusive preserve of the individual agencies. Because of a dearth of experienced prosecutors, the absence of statutory mandates for cooperation and the need for the expertise of other organizations such as Inland Revenue and customs, the FIG was unsuccessful.²¹⁷

The most serious fraud offenses are investigated by the police and are handled by a special group of officers in fraud squads. Each of the forty-three police forces in England and Wales has its own fraud squad, whose members are not specially trained. Metropolitan Police officers are posted to the fraud squad for three-year terms. The borough of the City of London, the home of the financial district, has its own police force. Officers join for a longer period, perhaps seven or eight years. The lack of any proper career structure within fraud squads and the qualifications of their members leave something to be desired. For instance, police investigations need expert accountancy advice which is largely obtainable through the retention of private sector accountants, an expensive undertaking.²¹⁸

Through its role as supervisor of the regulatory system for corporations and insurance companies, the DTI has many responsibilities relating to the control of fraud and the policing of corporate requirements.²¹⁹ It forwards evidence of fraud to the DPP. It can inspect companies, appoint inspectors with broad powers of investigation of a company's affairs, require the production of books and records, and report on inspectors' investigations. It has its own investigation staff, some of whom have police, accounting, or legal training. In the companies investigation branch, thirty-five members deal with investigations under section 447 of the Companies Act of 1985. Under that section, if the DTI thinks there is reason to do so, it can require a corporation to produce its books or records for examination. Inquiries under this section are not publicly announced. Failure to comply with a DTI request is a criminal offense. The Department can disclose to the police and the DPP information intended to show commission of a criminal offense. It has primary responsibility to prosecute insider dealing.

The DTI has fifty lawyers who are responsible for companies investigations. In the Legal Department there are four lawyers who provide advice to the company's investigations branch and deal with related prosecutions. An additional twelve lawyers and twenty-four investigating officers handle cases referred to them by the insolvency branch.²²⁰ When an investigation into a corporation's affairs indicates criminal violations, it will be handled by the DTI. More serious cases are referred to the DPP or to the SFO.

As discussed earlier in this article, the DTI has been ineffective. The House of Commons Select Committee on Trade and Industry found that the average time for completing a basic fact-finding (section 447) inquiry was 105

217. M. CLARKE, *supra* note 206, at 166-67 (noting that the FIG was at best "a modest start").

218. ROSKILL REPORT, *supra* note 209, § 2.73.

219. Companies Act 1985, ch. 6, §§ 431-34.

220. ROSKILL REPORT, *supra* note 209, § 2.16.

days. The delays were attributed to difficulty in arranging interviews, overseas banks in the affair, and the unavailability of inspectors who are often barristers who have responsibilities in court.²²¹ The Select Committee Report concluded: "Rarely can a government department's discharge of its responsibilities have been held in such low esteem among others involved."²²²

The Roskill Committee was particularly critical of the manner in which cases were investigated, prepared, and tried. It recommended a unified body charged with the investigation and prosecution of major fraud with a staff comprised of lawyers and accountants together with police officers acting under the control of one operational head.²²³ The government followed some of the Roskill Committee recommendations in establishing the SFO.²²⁴ The SFO, which commenced activity in January 1987, is a seventy person team of lawyers, accountants and support staff with extensive investigative and subpoena powers. However, the government did not bring the police under the SFO umbrella; they remain independent. Thus, the SFO will not be able to direct them and force coordinate action.

While the DTI had power to obtain information on insider trading, neither the police nor the Crown Prosecution Service had a specific authority to force witnesses to disclose information.²²⁵ The SFO has that authority, if in the course of investigating a suspected offense it appears that the office has good reason to believe there has been a complex fraud.²²⁶ The SFO can investigate any offense that appears to involve serious or complex fraud and may take over an investigation where such fraud appears to exist. If there is such good reason, the Director of the SFO may require persons to appear before him and to produce documents relating to the investigation.²²⁷ However, the SFO's powers are more limited than those of DTI inspectors investigating companies for insider dealings. The evidence that a suspect gives to the SFO under compulsion cannot be used against him in a criminal investigation, unless he gives contradictory evidence in court.²²⁸

While the SFO is a step toward coordinated enforcement, it has already come under criticism for the slowness of its investigations. It has had difficulty obtaining evidence from abroad and has been criticized for closing

221. *Reforms in DTI's Methods Urged*, Times (London), May 24, 1990, at 28, col. 1 [hereinafter *Reforms Urged*]. To ease the problem of delays, the Companies Act 1989, ch. 40, has given more flexibility to appoint investigators who will not publish a report (§ 55), to discontinue an inspection (§ 57) and to cooperate more fully with overseas regulators (§§ 82-83).

222. *Reforms Urged*, *supra* note 221, at 28, col. 8.

223. See ROSKILL REPORT, *supra* note 209, § 2.48.

224. Criminal Justice Act 1987, ch. 52, § 1(3) [hereinafter Criminal Justice Act]; see generally Wood, *Serious Fraud Office: Regulatory and Enforcement Changes in the United Kingdom*, in *INTERNATIONAL SECURITIES MARKETS* 219 (A. Beller ed. 1988).

225. Wood, *supra* note 224, at 233-34.

226. Criminal Justice Act, *supra* note 224, § 1(3), 2.

227. See *id.* § 2, which includes criminal penalties for failure to comply or knowingly making false statements or destroying documents.

228. Wolman, *supra* note 210.

courtroom hearings to the public.²²⁹ Also, the office has appeared to limit its reach. In December 1988, an assistant director stated that normally the SFO would not use its powers to investigate insider dealing because that is a regulatory offense, rather than a serious or complex fraud.²³⁰ The creation of the SFO is a half step on the road to efficient financial services enforcement. The ineffectiveness of insider dealing prosecutions demonstrates how much more is needed.

B. Insider Dealing

To the public, insider trading is perhaps the most notorious financial activity, for it casts doubt over the integrity of the financial markets. This section traces the development of insider dealing as a wrong, the statutory attempts to deal with it, the inability to stop such activity, and the failure of successful prosecution of inside traders. It analyzes the causes of the failures of enforcement and concludes with recommendations for reform.

Insider trading is the use of material, non-public, price sensitive information of an issuer or another corporation in the purchase or sale of securities, when the individual knows that the information has been wrongfully obtained. In the United States there has been a common law and later a statutory prohibition against the use of certain types of nonpublic information by individuals affiliated with a corporation, typically directors, officers, or large shareholders.²³¹ Widespread norms have developed that such behavior is unethical. Recent litigation has been over the breadth of the net that prohibits insider trading.²³²

In the United Kingdom, in contrast, insider dealing did not become illegal until 1980. Particularly in the context of takeovers, within a relatively closed investment community, such dealing was considered a customary way of doing business in the City, a sort of fringe benefit.²³³ Insider trading was tolerated because it helped to maintain an "orderly market," that is, one in which professionals did not lose money.²³⁴ Because of single capacity and functional regulation of financial services, conflicts of interest within firms, which resulted in insider dealing, were less likely to arise. Even today, while there may be greater agreement that insider trading is morally wrong, many do not feel it should be prohibited.

229. Tendler, *Problems Gaining Evidence Abroad Slows SFO's Work*, The Times (London), July 14, 1989, at 28, col. 1.

230. Wolman, *UK Treads Carefully over Insider Trading*, Fin. Times, Feb. 7, 1989, at 28, col. 4.

231. Strong v. Repide, 213 U.S. 419 (1909); Securities Exchange Act of 1934 §§ 10(b), 16(b), 15 U.S.C.A. §§ 78j(b), 78p(b) (West Supp.1991); SEC Rule 10b-5, 17 C.F.R. (1990) § 240.10b-5 (1990).

232. Carpenter v. United States, 484 U.S. 19 (1987); Dirks v. Securities and Exchange Commission, 463 U.S. 646 (1983).

233. Lohr, *The Case for an SEC in Britain*, N.Y. Times, Nov. 23, 1986, at F9, col. 1.

234. *Paper Walls*, The Times (London), Aug. 16, 1978, at 11, col. 1.

Insider dealing violations are particularly difficult to detect. To obtain a successful conviction the necessary connection must be made between the investor and the possession of inside information. An investigator must learn what the insider dealer knew, when he knew it, and how he found it out. Usually there are two witnesses, the source and the inside dealer. Unless one of them confesses, the proof of the violation must be gleaned from patterns of trading. Although the computerization of trading provides tracks, much insider dealing is based upon circumstantial evidence.²³⁵

Insider dealing can be conducted quite subtly. An investment banker or broker might tip off a fund manager obliquely, "I wouldn't sell X" and be rewarded later with commissions after "X" has been taken over by "Y" at a substantial premium.²³⁶ Despite the institution of internal controls by firms and added enforcement powers required by the F.S.A., insider dealing among financial services firms is believed to be widespread. According to a poll of institutional fund managers in February 1989, when asked "how effective would you say are the present arrangements for monitoring insider dealings?" over one-half responded that they believed them to be ineffective.²³⁷

1. Restraints On Insider Trading Before 1980

Prior to 1980, while there was no statutory prohibition against insider trading, there were requirements that directors observe fiduciary responsibilities and disclose and report their interests in the securities of their company, and in some circumstances, interests in other companies.²³⁸ More importantly, the rules of the Stock Exchange required listed companies to have internal regulations governing transactions of directors. The Stock Exchange's code for dealing with securities in which a firm has an interest or information is a minimum standard, yet it exceeds the scope of the statutory Insider Dealing Act.²³⁹

The Panel on Takeovers and Mergers required extensive disclosure of dealing and had rules relating to the use of confidential price-sensitive information in the context of a tender offer. The code, however, did not have the force of law. The Panel would censure a violator, would refer the matter to the DTI, or would get the City establishment to exert pressure, in ways such as by drying up sources of capital.²⁴⁰ Other self-regulatory bodies, such as

235. See H.R. REP. NO. 910, 100th Cong., 2d Sess. 15, reprinted in 1988 U.S. CODE CONG. & ADMIN. NEWS 6043, 6052 (discussing need for Insider Trading and Securities Fraud Enforcement Act of 1988).

236. Brewerton, *The Fat Old Grouse Gets Away with It Again*, *The Times* (London), Aug. 17, 1988, at 21, col. 6.

237. Beresford and Blackhurst, *Insider Dealers Stay One Step Ahead*, *Sunday Times* (London), Feb. 26, 1989, at D1, col. 2.

238. Companies Act 1967, ch. 81, §§ 27-29, amended by Companies Act 1985, ch. 6, §§ 235, 324-328, sched. 13, pts. I, IV.

239. COUNCIL OF THE STOCK EXCHANGE, *ADMISSION OF SECURITIES TO LISTING* §§ 5.39, 5.41-48 (2d ed. 1985).

240. See *supra* M. CLARKE, note 206, at 109-14.

the Council of the Law Society, the Institute of Directors, and the Society of Investment Analysts, had guidelines or policies against insider dealing.²⁴¹

In 1974, the Stock Exchange developed surveillance facilities designed to identify insider transactions. It established a surveillance team in 1981. Originally its stock watch program relied upon a stream of market prices from jobbers on the trading floor. Suspicious price movements were spotted by eye and would be referred to an investigation's manager. If the movements seemed other than a normal fluctuation, a committee of the Council of the Stock Exchange would conduct a preliminary investigation.²⁴² The preliminary investigation was an in-house inquiry, in which evidence was taken from the firm. Most such investigations were settled informally. In the words of a senior official of the Securities Association, "club rules were utilized, which were very effective among members." This meant that a telephone call might unglue the transaction and lead to internal sanctioning by the firm. Regulation of insider dealing was suggested by the Jenkins Committee as far back as 1962,²⁴³ but did not become law until 1980.

2. *The Company Securities (Insider Dealing) Act, 1985*

In contrast to the United States and other jurisdictions, insider trading in the United Kingdom is only a criminal offense: there are no civil remedies. The prohibition applies only to transactions listed on a recognized investment exchange.²⁴⁴ The statute prohibits insiders from dealing, counseling or procuring anyone else to deal, or communicating any information to any person, if he knows or has reasonable cause to believe that another person will make use of that information to deal on a recognized stock exchange in securities of his company or any other company with which he is connected and holds unpublished price-sensitive information.²⁴⁵ Also prohibited from such trading are individuals who receive such information (tippees), crown servants and other public officials (employees of the SIB or SROs), and individuals involved in takeovers.²⁴⁶

An insider is one who, within the preceding six months, knowingly has been connected with or has been a director of that company or a related

241. B. RIDER, *INSIDER TRADING* 113-14, 122-26 (1983).

242. *Id.* at 127, 148-51; *Insider Trading in London*, *ECONOMIST*, Feb. 7, 1987, at 74.

243. Report of the Company Law Committee, Cmnd. 1749, ¶ 89 (1962). During the 1970s, the subject dominated discussions of company law reform, securities regulation, and the adequacy of City self-regulation. See generally B. RIDER, *supra* note 241, ch. 6. Unsuccessful attempts were made to introduce such legislation in 1973 and 1978. Finally, in 1980 it became unlawful.

244. See Bornstein & Dugger, *International Regulation of Insider Trading*, 2 COLUM. BUS. L. REV. 375, 388-89 (1987). For a discussion of the insider trading legislation, see B. HANNIGAN, *INSIDER DEALING* (1988); J.H. FARRAR, *supra* note 25, at 344-58; A. WEDGWOOD, G. PELL, *supra* note 57, at 97-121.

245. Company Securities (Insider Dealing) Act 1985, ch. 8, §§ 1-2 [hereinafter *Insider Dealing Act*].

246. *Id.* §§ 1(3),(4) (1980); F.S.A., *supra* note 1, § 173(2); *Insider Dealing Act*, *supra* note 245, § 1(5) (1980).

company, or is an officer or employee, or has occupied a position with the company involving a professional or business relationship.²⁴⁷ The insider must be in possession of unpublished price-sensitive material, which he holds by reason of his connection with the company.²⁴⁸ Also, it must be reasonable to expect a person so connected, and in that position by virtue of which he is connected, not to disclose that information except for the proper performance of the functions attaching to that position.²⁴⁹ Additionally, he must know that the information is unpublished price-sensitive information in relation to those securities.²⁵⁰

"Unpublished price-sensitive information," or in American jargon "material non-public information,"²⁵¹ is information that relates to specific matters of concern to the company and that is not generally known to those persons who are accustomed to or would be likely to deal in those securities, but that if it were generally known to them, would be likely to affect materially the price of those securities.²⁵² Whether information is price-sensitive is a question of fact for a court.

When an insider knowingly comes in possession of non-public price-sensitive information, he may not deal on a recognized stock exchange in those shares.²⁵³ Nor may he deal in the shares of another corporation, if he fills the insider criterion in relation to that other company, and the information relates to a transaction between the two companies, such as a takeover bid.²⁵⁴ The insider cannot pass the information to someone else to trade or to any person whom the tipper has reasonable cause to believe will make use of the information for purposes of dealing, or counseling, or procuring any person to deal on an exchange.²⁵⁵

Persons, such as tippees, who trade on inside information received from insiders may also be guilty of an offense under the Insider Dealing Act. A tippee is an individual who is in possession of unpublished price-sensitive information, which he knowingly obtained (directly or indirectly) from another individual, the insider, and who the tippee knows or has reasonable cause to believe held the information by virtue of being so connected. The tippee must know or have reasonable cause to believe that because of the tipper's connection and position, it would be reasonable to expect him not to disclose that information.²⁵⁶ Tippees are prohibited from trading.

247. Insider Dealing Act, *supra* note 245, §§ 1, 9.

248. *See id.* § 1(1)(a).

249. *See id.* § 1(1)(b).

250. *See id.* § 1(1)(c).

251. The definition of material is found in *TSC v. Northway*, 426 U.S. 438, 449 (1976).

252. Insider Dealing Act, *supra* note 245, § 10.

253. *See id.* § 1(1)(c).

254. *See id.* § 1(2)(5). This prohibition would not relate to a transaction involving a third party. *Cf. Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984).

255. Insider Dealing Act, *supra* note 245, §§ 7-8.

256. *Id.* § 1(3).

There are some exceptions to the insider trading prohibitions. They include individuals who deal as liquidators, receivers, or trustees in bankruptcy and individuals stabilizing the price of international bond issues for a specified period. In addition, an individual who commences a trade before receiving the price-sensitive information, may complete the transaction.²⁵⁷ The Act does not prohibit an individual, by reason of his possession of information, from doing any particular thing, other than with a view to making a profit or avoiding a loss for himself or some other person, by use of that information.²⁵⁸ This clause, together with the scienter requirements, creates a sufficient safety net for directors who want to trade in their company's shares or someone who wants to pay off a pressing debt.²⁵⁹

Violation of any of the provisions of the Insider Dealing Act is a criminal offense, punishable by as much as two years imprisonment and/or an unspecified fine.²⁶⁰ No transaction is void or voidable by reason of violation of the act.²⁶¹ English law is less responsive to implied rights of action and to expanded fiduciary responsibilities of directors to shareholders. Several cases have involved corporate opportunities in which damages to the company have not been granted because provable injury to the corporation was lacking.²⁶² Professor Barry Rider, an expert on insider trading, has written: "Given the clear intention of Parliament not to provide an express civil remedy in such cases, and the almost insoluble questions of causation and determination of damages that would arise in other than direct personal transactions, it is submitted that it would be most unlikely that a court would be prepared to find such a cause of action."²⁶³ Still, the SIB might use injunctive or restitutionary actions under section 61 for breach of the conduct of business rules. However, this section would apply only to an insider trading transaction by an authorized individual or firm and might exempt an outside director who is not in the financial services sector save for his board service.

3. *The Financial Services Act and Insider Dealing*

The F.S.A. was only incidentally concerned with insider trading. Several sections were technical amendments to the 1985 Insider Dealing Act,²⁶⁴ made to take account of changes in trading wrought by the "Big Bang." For example, employees of the SIB and recognized bodies were forbidden to trade on the basis of material non-public information.²⁶⁵

257. *Id.* §§ 3(1)(b)(c), 3(2), 6.

258. *See id.* § 3(1)(a).

259. J.H. FARRAR, *supra* note 25, at 354.

260. Insider Dealing Act, *supra* note 245, § 8.

261. *See id.* § 8(3).

262. J.H. FARRAR, *supra* note 25, at 356.

263. B. RIDER & D. CHAIKEN, *GUIDE TO THE FINANCIAL SERVICES ACT 1986* 121 (1987).

264. Insider Dealing Act, *supra* note 245, at ch. 8.

265. Section 2 of the Insider Dealing Act prohibits crown servants, that is civil servants, from using "price sensitive" information. F.S.A. § 173 replaces the word "crown servant" with

Sections 177 and 178 furnish increased powers to investigate suspected inside trading. The Insider Dealing Act had no provision for the investigation of suspicious price movements. Thus, it had been difficult to obtain sufficient evidence to prove beyond a reasonable doubt that an individual traded while in possession of non-public price-sensitive information and did so with scienter.²⁶⁶ Section 177 gives the Secretary of State for Trade and Industry the authority to appoint inspectors to investigate suspected insider dealing. The inspectors are to report to the DTI the results of their inquiry.²⁶⁷

Any person who is knowledgeable about or is a suspect in any contravention under the Insider Dealing Act may be required by the inspectors to produce documents in their possession or under their control relating to the company in question whose securities may have been improperly traded, to appear before the inspectors, and to otherwise provide assistance in connection with the investigation.²⁶⁸ Statements by a person in compliance with the request from an inspector can be used in evidence against him. Inspectors may examine under oath any person who may give information concerning insider dealing and shall make such interim and final reports that they think are necessary. The final report is submitted to the Secretary of State, who then decides whether to bring criminal proceedings.

Section 178 provides penalties for failure to cooperate with section 177 investigations. If a person refuses to comply with a request or refuses to answer any question put to him by an inspector, the inspectors then certify such to a court which will then inquire into the case. After a hearing, if the court is satisfied that there was non-cooperation without a reasonable excuse, it may punish the individual for contempt.²⁶⁹ In the alternative, the court may direct that the Secretary of State exercise his powers, which include: cancellation of authorization to carry on investment business, disqualification from becoming authorized, and prohibitions from entering into transactions of specified kinds or with specified persons.²⁷⁰

Section 178(6) attempts to close a previous loophole in the investigation of insider trading cases.²⁷¹ Often a suspect refused to furnish information or cooperate on the grounds that at the time he was not aware of the identity of

that of public servant, which has a broader meaning. As the SIB and the recognized bodies are private organizations, their employees are not crown servants. Other technical changes related to the changes in the method of trading. F.S.A., *supra* note 1, § 174.

266. A. WHITTAKER & G. MORSE, *THE FINANCIAL SERVICES ACT 1986: A GUIDE TO THE NEW LAW* 191 (1987).

267. F.S.A., *supra* note 1, § 177(1).

268. *Id.* § 177(3).

269. *Id.* § 178(3).

270. *Id.* § 178(2).

271. *Id.* § 178(6) (interpretation of reasonable excuse in § 178(2) states: A person shall not be treated for the purposes of subsection (2) above as having a reasonable excuse for refusing to comply with a request or answer a question in a case where the contravention or suspected contravention being investigated relates to dealing by him on the instructions or for the account of another person, by reason that at the time of the refusal —

(a) he did not know the identity of that other person; or

other persons involved or was subject to the law of another jurisdiction prohibiting such disclosure. The requirements under the Conduct of Business Rules of the SIB and various recognized bodies requiring a firm to "know their customer"²⁷² will undermine this traditional excuse. The penalties against an individual who fails to cooperate with the section 177 investigation can be used by the recognized bodies against one of its members but are subject to a reservation that they are to be exercised concurrently with the DTI.²⁷³ The F.S.A. insider dealing sections allow the DTI to more easily investigate suspected wrongful trading and appoint the SIB to head the investigation.

The Stock Exchange's surveillance department examines approximately forty-five cases per week for suspicious price movements. Roughly twenty are passed onto the surveillance department's Insider Dealing Group. After this review, approximately ten cases per week are referred to a second group for additional investigation.²⁷⁴ Thereafter, the matter may be referred to the DTI for investigation with the aim of eventual criminal prosecution. Despite these additional investigating powers insider dealing continued after the enactment of the F.S.A. and a series of notorious scandals tarnished the effectiveness of the enforcement framework and particularly the DTI.

4. *Violations of the Insider Dealing Act in the Late 1980s*

Insider trading activities have occurred with depressing regularity since the Big Bang. Many of these cases have arisen because of breaches in a firm's "Chinese Wall." A Chinese Wall is a prohibition against the passing of confidential information from one department of a financial services institution to another.²⁷⁵ Firms are expected to erect barriers between sources of material non-public price-sensitive information and securities brokers. Unfortunately, these barriers, like the original Chinese Wall, are often breached.

Prior to the Big Bang, securities firms were separate from merchant banks, which were separate from clearing banks. The breakdown in functional barriers now meant that under the roof of a single firm would be individuals knowledgeable about proposed takeovers, departments with inside information about the corporate health of a particular client, and brokers acting as market makers and for clients as agents selling shares of companies.

(b) he was subject to the law of a country or territory outside the United Kingdom which prohibited him from disclosing information relating to the dealing without the consent of that other person, if he might have obtained that consent or obtained exemption from the law.)

272. See SIB CONDUCT OF INVESTIGATION RULES, *supra* note 122, at ch. 3.01-.03; ASSOCIATION OF FUTURES BROKERS AND DEALERS LIMITED RULEBOOK, rule 5.2 (1989); FIMBRA RULES, *supra* note 185, at ch. 4, rule 2; THE SECURITIES ASSOCIATION RULES, ch. IV, rule 650 (1989) [hereinafter TSA RULES].

273. F.S.A., *supra* note 1, § 178(10).

274. Unsworth, *Insider Dealing Sleuths at SE*, *The Times* (London), Aug. 20, 1988, at 23, col. 2.

275. A SUPPLEMENT TO THE OXFORD ENGLISH DICTIONARY 503 (2d ed. 1972). Its name derives from the great wall built between China and Mongolia in the third century B.C.

The SIB's rules and those of the SROs require firms to have internal policies against trading where there is a conflict of interest as well as a firm policy on its responsibilities where the firm has an interest in a particular security. The firm must also have compliance procedures to monitor such trading by employees.²⁷⁶ Breaches of a Chinese Wall are difficult to monitor. Unlike the earlier insider trader cases, those involving Chinese Wall breaches have been individuals at old line firms. Often the trading was not conducted for personal enrichment, but for the firm's benefit.

Before the Big Bang, L.C.B. Gower had pointed out that the "lack of effective and successful enforcement up to now [of the Insider Dealing Act] has been disturbing."²⁷⁷ To improve enforcement, the F.S.A. introduced several amendments to the Insider Dealer Act of 1980. If it appears to the Secretary of State that there are circumstances suggesting insider trading, he may appoint one or more competent inspectors to carry out such investigations as are necessary to establish whether any such contravention occurred and to report the results of their investigations to him.²⁷⁸ This is a nondelegable responsibility.

The Insider Dealing sections of the F.S.A. were scheduled to be implemented in 1987. However, several flagrant insider trading incidents occurred in the latter part of 1986 which altered the permissive attitude in the City toward such transactions. The Secretary of State implemented the insider trading provisions one year early. These new insider trading schemes did not involve a misguided, low-level employee attempting to make a one-time killing; rather they were sophisticated conspiracies by experienced individuals.

Because of the computerization and technological developments nurtured by the Big Bang, for the first time the stock market tape was transparent so that all trading could be traced. Theoretically, it should have been more difficult to engage in insider dealing because the price, volume, and time of all equities transactions were reported to the Stock Exchange within minutes of the transaction. Prior to the Big Bang, trades were reported the following day, but without the time of the transaction.²⁷⁹ Paradoxically, even with this new capacity to detect improper dealing, ever greater scandals occurred.

One of the ripples of the U.S. insider trader scandal involving the arbitrager, Ivan Boesky, was that he earned fifty million dollars from insider trading activities conducted through a British investment trust, Cambrian and General Securities, of which he was chairman. The U.S. Securities and Exchange Commission (SEC) discovered the U.K. activities and transmitted information to the DTI under terms of a Memorandum of Understanding

276. SIB CONDUCT OF INVESTIGATION RULES, *supra* note 122, rules 14.02-.03, 15.01-.02; TSA RULES, *supra* note 272, rule 550.01(b); FIMBRA RULES, *supra* note 185, rule 4.19, 4.24.

277. L. GOWER, REVIEW OF INVESTOR PROTECTION: REPORT PART II § 6.22 (1985).

278. F.S.A., *supra* note 1, § 177.

279. Kohut, *U.K. Reforms Ensure Probity — Stock Exchange Chief*, REUTERS MONEY REP., Jan. 27, 1987.

(MOU), signed by both governments in September of 1986 to share information involving securities and commodities violations.²⁸⁰ No one doubts that if the SEC had not transmitted information about Boesky's U.K. securities activities, the DTI would never have discovered them.

The SEC's investigation of Boesky raised questions about his role in the bitter battle between Guinness, the beverage and distillery company, and Argyll Group, in which each sought to take over Distillers Company, a leading maker of Scotch whiskey (Johnny Walker and Dewars). In April 1986, Guinness was the victor with a 3.8 billion dollar cash and stock bid. Based upon information passed by the SEC, the DTI commenced an investigation in December 1986 pursuant to sections 432 and 422 of the Companies Act.²⁸¹ The DTI believed that a number of supposedly independent investors acted in concert to inflate the value of Guinness shares and purchased Distillers stock to pledge it to Guinness.²⁸²

Boesky first approached Argyll and offered to buy Distillers shares and warehouse them, that is, hold them for Argyll. Argyll declined. Apparently, Guinness was more cooperative because Boesky purchased Distillers shares shortly before the takeover. These shares were ultimately sold to Guinness. Additionally, Guinness invested one hundred million dollars in a fund run by Boesky.²⁸³ Guinness purchased its own shares in order to drive up the price, thereby making the purchase of Distillers less expensive.

The Guinness affair sent shock waves throughout the City and the government. Former conservative Prime Minister Edward Heath denounced what he called "an orgy of insider dealing." Roy Hattersley, Labor Party spokesman, accused the government of being too friendly with "sleazy financiers."²⁸⁴ Guinness demonstrated the ability of insider dealers to use nominee accounts to disguise themselves and the difficulty of discovering breaches of the insider trading statute.

In November 1986, Geoffrey Collier, the head of stockbroking at Morgan Grenfell, one of Britain's oldest and most patrician merchant banks, resigned after breaching his firm's insider trading rules by dealing in the shares of an engineering company subject to a takeover bid by one of the bank's clients.²⁸⁵ While Collier only earned twenty-two thousand dollars from his insider dealing, next to nothing compared to Boesky, the fact that he was at the heart of the City establishment created a widespread belief that his actions were but the tip of a corrupt iceberg, and that the Big Bang had nurtured a

280. Memorandum of Understanding on Exchange of Information Between the SEC, CFTC, and the United Kingdom Department of Trade and Industry in Matters Relating to Securities and Futures, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,027 (Sept. 23, 1986) [hereinafter MOU].

281. Section 432 relates to fraud, misfeasance or other misconduct, and nondisclosure of information to shareholders that they might reasonably expect. Companies Act, 1985, § 432.

282. *Is Boesky Good for Guinness?*, *ECONOMIST* 91, Dec. 6, 1986, at 91.

283. *Two More Quit in Guinness Scandal*, *N.Y. Times*, Jan. 21, 1987, at D19, col. 1.

284. *Id.*

285. HANNIGAN, *supra* note 244, at 23-24.

freewheeling, unregulated, dishonest environment.²⁸⁶ The Stock Exchange referred the matter to DTI, and Collier later received a one year suspended sentence, a twenty-five thousand pound fine, and had to pay court costs of an additional seven thousand pounds.²⁸⁷ These cases focused attention upon insider trading, yet new scandals appeared with distressing frequency. Even the DTI became more active in investigating allegations of insider dealing.

The government was scandalized by the alleged insider dealing of two civil servants who used price-sensitive information in the course of their duties monitoring takeover bids for the Office of Fair Trading and the Monopolies Commission.²⁸⁸ That public officials were involved was particularly shocking. In this period the government had real concern that the new discoveries of insider trading would force the SIB to become a Securities and Exchange Commission. These incidents suggested that the liberalization of the market's structure provided new avenues for corruption. They demonstrated weaknesses in the financial services sector's ability to regulate itself.

In September 1987, two clerks employed by the respected financial newspaper, the *Financial Times*, traded on the basis of published information that was not yet distributed to the general public. The employees, who were statisticians for FINSTAT, the paper's electronic share service subsidiary, gained prior publication access to copies of the *Investor's Chronicle*, a weekly business magazine that recommended low priced shares. The clerks purchased the touted shares in advance and sold them when the recommendations became public. Because the shares were thinly traded, it was easy to pick up the movement in share prices. The editor of the *Investor's Chronicle* noticed the share movements and informed the Stock Exchange, which traced the transactions. The employees were terminated, because they violated a *Financial Times* internal policy. The newspaper, however, insisted that this was an insignificant incident, marked by amateurish tactics and small sums of money.²⁸⁹

Recently, the DTI has had difficulties in obtaining convictions. At the end of 1989 three major cases were dismissed by the courts. In one the director of an offeror purchased shares in a target company while negotiating on behalf of the offeror for purchase of a stake in the target. At the time the target's market price was 54 pence. The acquirer was offering 90 and the

286. Lohr, *supra* note 233.

287. *British Insider Fined \$40,000*, N.Y. Times, July 2, 1987, at D7, col. 6.

288. Joseph, *Probe Marks New Twist in British Insider Trading Scandal*, REUTERS, Dec. 21, 1986. The defendants were ultimately acquitted because the prosecution abandoned the case after the Director General of Fair Trading claimed that it would not be in the public interest for OFT documents relating to takeovers to be discussed at trial. Hughes, *Campaign Against Insider Dealing Suffers Setback*, Fin. Times, Jan. 24, 1990, at 11, col. 4.

289. Lohr, *Financial Times Dismisses 2*, N.Y. Times, Sept. 15, 1987, at D5, col. 1. Cf. *Carpenter v. United States*, 484 U.S. 19 (1987) (U.S. Supreme Court divided 4-4 on whether a columnist's trading on information contained in his columns was an insider trading violation on the basis of misappropriation of an employer's information); *Securities & Exch. Comm'n v. Texas Gulf Sulphur*, 446 F.2d 130 (2d Cir. 1971) (information not publicly distributed until it appears on Dow Jones tape and investors have a chance to react to it).

director made several purchases commencing at 65. The information was price-sensitive. The defendant had knowledge of the negotiations and was a classic insider.

The defendant argued that the information was in the public domain. A prosecution witness, the chairman of the offeror, called to produce documents, testified on cross-examination that he thought he could purchase the target's shares at the time because the offeror was not engaged in a tender offer but only a negotiated purchase, therefore the information was not price-sensitive. The judge directed a verdict for the defendant because of conflicting evidence.²⁹⁰ In another case, the conviction of a managing director under section (1)(1) with a fine of 7000 pounds was reversed on appeal. By the beginning of 1990, of the sixteen people charged under the 1985 act, there were only five convictions, of which four pleaded guilty.²⁹¹

In mid-1988, there were recurring breaches of Chinese Walls by employees of City institutions. Two dealers at County NatWest Wood-Mac, the investment banking subsidiary of the U.K.'s second largest bank, National Westminster, were dismissed for dealing on inside information relating to a proposed sale of Intercontinental Hotels. County NatWest was the advisor to the owner of the hotel chain, Grand Metropolitan. The bank's corporate finance department informed the dealing room of the proposed sale, and two market makers purchased shares from other market makers. However, the individuals did not themselves benefit. The sales were for the benefit of the bank.²⁹²

In the same week, three brokers from different firms were discovered to have used inside information to purchase shares of a casino-hotel corporation, Pleasurama, in advance of a tender offer. The three firms, Samuel Montague, Morgan Grenfell, and Lazard Brothers, were all members of the City's establishment. In each case the corporate finance departments leaked information to other departments. While dealing rooms routinely transcribed all telephone calls, the corporate finance departments did not. In each case the employees were dismissed. The insider dealing was uncovered only when those who sold to the insiders complained. If the transactions involved market makers dealing with the public, it is possible that nobody would have known.²⁹³

In the third incident of the week of August 14, 1988, the Stock Exchange examined an apparent leak of information immediately before the government's announcement of a referral of a tender offer bid to the Monopolies

290. Hughes, *A Case of Frustration for the DTI*, *Fin. Times*, Nov. 28, 1989, at 10, col. 7.

291. Hughes, *Insider Dealing Conviction Overturned*, *Fin. Times*, Jan. 26, 1990, at 1, col. 1.

292. *Leading Bank Sacks Two for Insider Dealing*, *The Times* (London), Aug. 12, 1988, at 1, col. 1.

293. *New Insider Shock Hits City*, *Sunday Times* (London), Aug. 14, 1988, at D1, col. 1; *Insider Deals Prompt City Security Check*, *The Times* (London), Aug. 15, 1988, at 19, col. 2; *SE Widens Net on Dealing in Pleasurama*, *The Times* (London), Aug. 16, 1988, at 11, col. 1; *The Fat Old Grouse Gets Away with it Again*, *The Times* (London), Aug. 17, 1988, at 21, col. 6.

Commission. Such a referral normally would cause a decline in share price. One minute before the public announcements, and four minutes after advisors to the companies involved in the takeover bid were informed of the referral, there were three trades prior to a sharp decline in the stock price.²⁹⁴

The next week, Kleinwort Benson dismissed one salesman and suspended another for personal stock transactions in violation of the firm's rules. The policy of most City institutions is that all employee share dealings must be carried out through the firm's own brokerage subsidiary or a company that it uses. This enables employee transactions to be monitored by the in-house compliance staff. In this case the brokers used outside brokers to trade in the shares of an over-the-counter company that was engaged in preliminary talks on an oil and gas investment deal, which would normally, when announced, cause the shares to rise.²⁹⁵

5. *The Failure of Enforcement*

The enforcement of the insider dealing statute has been ineffective. One problem has been the high burden of proof required for conviction under a criminal statute. As mentioned, egregious insider trading prior to the F.S.A. was handled internally by the Stock Exchange. There was little due process for those charged, and no required burden of proof. A second enforcement difficulty is that insider trading investigations, even with transparent trading, requires substantial resources. Major insider trading is conducted by organized rings operating offshore using nominees and dummy corporations.²⁹⁶ International cooperation and coordination are required for successful investigations.

A third problem has been the ineffectiveness of the DTI's Investigation Branch.²⁹⁷ Under the Companies Acts, the DTI can appoint investigators to examine under oath and to inspect the books and records and affairs of corporations. Insider trading enforcement requires specialized experience, yet when the Insider Dealing Act was first enacted in 1980, the government declined to include special investigatory powers that had been introduced in an earlier bill. The government's view was that since special investigatory powers were not required for murder cases, they should not be needed for cases of insider dealing.²⁹⁸

294. Jay, *Insiders in Early Bale-out*, Sunday Times (London), Aug. 21, 1988, at D1, cols. 2-3.

295. Lever, *Kleinwort Salesman Sacked for Breach of Share Rules*, The Times (London), Aug. 24, 1988, at 23, col. 6.

296. Wolman, *Insider Dealing Rings "Operate Offshore Links"*, Fin. Times, Mar. 4, 1986, at 1, col. 1.

297. See generally B. RIDER, *supra* note 241, at 283-325.

298. *Id.* at 116-17.

a. *The Enforcement Record*

The DTI's dismal record of insider trading investigations and prosecutions demonstrates the weakness of its statutory power and organizational commitment to enforcement. From 1980 to March 1986, the Stock Exchange conducted 284 investigations of insider trading and referred ninety-three cases to the DTI, which prosecuted only five, resulting in three convictions.²⁹⁹ Of those 284 investigations, fifty involved offshore companies.³⁰⁰ The number of prosecutions increased only slightly toward the end of 1986. Over one hundred cases had been brought to the DTI's attention, resulting in a cumulative total of nine prosecutions by the end of the year. The Labor Party noted that during the same period, 138,918 social service claimants were prosecuted for fraud.³⁰¹ The comparison was not complete, for insider dealing more often than not involved complex, sophisticated, international commercial fraud. At one point in 1986, the DTI asked the Stock Exchange to be more selective when referring suspected cases of insider trading to the Department.³⁰² The request for a more judicious referral policy reflected the Department's lack of priority for these cases.

In 1989 the Stock Exchange Insider Dealing Group sent an average of one case of suspected Insider Trading per week to the DTI. In these cases, it took an average of eleven months for the DTI to complete its basic fact finding. In February 1989, it had thirty-nine cases in its docket: four awaiting trial, fifteen being investigated by DTI inspectors, two on special inquiries, and eighteen that await a decision on whether to appoint investigators.³⁰³ By 1990 the DTI's ten-year scorecard totalled twenty-six prosecutions and eleven convictions.³⁰⁴ None of those convicted has been sentenced to prison. Those convicted are fined, but not always to the full extent of their profits.

The early cases brought forward for prosecution involved the occasional insider dealer, often a lower-echelon employee, such as a secretary, who had made a one-time prohibited trade. The defendants were unsophisticated and were caught because of naivete or stupidity. They did not try to hide their purchases or profits. The sums involved were small — one thousand to ten thousand pound profits — as were the fines. Invariably, the perpetrators

299. Lever, *Exchange Told Not to Act on Hunches of Inside Dealing*, The Times (London), Mar. 5, 1986, at 17, col. 4.

300. Wolman, *supra* note 296.

301. *City Scandals: Lovely for Labour*, ECONOMIST, Dec. 6, 1986, at 66-67.

302. Lever, *supra* note 299.

303. *Reforms Urged*, *supra* note 2221, at 28, col. 1; Beresford and Blackhurst, *Insider Dealers Stay One Step Ahead*, Sunday Times, Feb. 26, 1989, at D1, col. 2. The Government has been unsuccessful in obtaining convictions when it prosecutes inside traders. Hughes, *Third Case Fails on Share Dealing*, Fin. Times, Nov. 23, 1989, at 10, col. 5.

304. Rice, *Insider Dealing: Legal Failings Lead to Pressure for Reform*, Fin. Times, Feb. 7, 1990, at 8, col. 1.

were fired or resigned from their positions.³⁰⁵ The cases were tried in provincial courts and officially unreported.³⁰⁶ In the most publicized of the early cases, Maurice Naeger, a director of W.H. Smith, the U.K.'s largest news distributor, traded on advance information of a takeover bid. His profit was 4200 pounds, his fine 1300 pounds. Since he was scheduled previously to retire as director, he was not otherwise punished.³⁰⁷

The investor protection system's reporting requirements and the increased computerization of securities trading enabled the Stock Exchange to monitor suspected insider dealing. However, the gains in detection were not matched by improvements in prosecution. The DTI and the other enforcement bodies were burdened by statutory and organizational weaknesses, along with a lack of experience in prosecuting commercial fraud.

b. Organizational and Statutory Weaknesses

The Stock Exchange has been by far the most successful in uncovering suspected insider trading. Yet, its effectiveness was often nullified when the results of its surveillance were turned over to the DTI, which would then conduct an investigation and forward its results to the appropriate prosecutor. This was a rather circular approach.

The 1989 Companies Act empowered the DTI to delegate investigatory and prosecutorial powers to the Stock Exchange on a case-by-case basis for simple insider dealing violations.³⁰⁸ The Exchange has been successful in its initial prosecutions.³⁰⁹ It can act more swiftly than the DTI and seems to have more expertise. Granting the Exchange such powers is a step in the right direction, but a more widespread delegation of investigatory and prosecutorial powers to investigate commercial fraud should be furnished to a separate agency, probably the SIB.

The main statutory weaknesses of the Insider Dealing Act are the lack of civil or administrative remedies, and the amorphous definition of the crime. There have been suggestions of lowering or shifting the burden of proof in insider trading prosecutions.³¹⁰ However, the creation of civil and administrative remedies might serve the same purpose. A civil remedy would also

305. J.H. FARRAR, *supra* note 25, at 357.

306. See 2 COMPANY LAW. 278 (1981)(*Bryce's case*); 3 COMPANY LAW. 185 (1983)(*Dickenson's case*); 4 COMPANY LAW. 117 (1983)(*Titheridge's case*).

307. The case is unreported but discussed in HANNIGAN, *supra* note 244, at 79-80.

308. Companies Act 1989, ch. 40, § 209 (1989).

309. Hughes, *Convicted as SE Wins First Insider Dealing Case*, Fin. Times, Nov. 8, 1990, at 24, col. 2. Two brothers were convicted of selling shares in a corporation shortly before it warned of losses. They learned of the corporation's problems from the company's accountant. By selling their stock, the brothers saved approximately 5,000 pounds. They were fined a total of 1250 pounds plus costs. Durman, *Two Plead Guilty to Insider Deals*, Independent, Nov. 8, 1990, at 26, col. 2.

310. The Select Committee Report castigated DTI's procrastination and general role in presenting insider dealing cases. The Committee recommended that the burden of proof in insider dealing cases shift to the defendant once a *prima facie* case had been made. To expedite the resolution of insider trading matters, the Report recommended that penalties be more flexible

quicken many investigations and result in the disgorgement of gains. Administrative remedies may already exist in the ability of recognized bodies' to discipline members engaged in insider trading for violations of the conduct of business rules,³¹¹ or similar rules of the appropriate recognized body.

Because of a drafting error in the F.S.A., the scope of insider dealing investigations had to be restricted. Section 177, which gives the DTI the power to appoint outside inspectors with the right to question witnesses under oath, could only be used prospectively for contraventions of the Insiders Dealing Act of 1985, which consolidated the prior insider dealing statutes. This Act became effective in the second half of 1985, and investigators examining share dealings that predated that statute could not use section 177.³¹²

When the DTI receives evidence of insider dealing violations, it can: 1) appoint inspectors under section 177 of the F.S.A.; 2) prosecute without appointing inspectors; 3) authorize the stock exchange to prosecute; or 4) take no additional action but inform other regulators. From 1980 until 1989, it often took the last course of action. Insider dealing investigations are but a small part of the DTI's responsibilities. Under the Companies Act it is responsible for enforcing the corporate law statutes, and can undertake fact-finding inquiries of company law violations.³¹³ When inspectors were appointed, particularly for company law violations,³¹⁴ they were usually accountants or Queens Counsel³¹⁵ with full time outside practices. More recently, DTI has appointed its own staff, officials of the SIB or of a recognized body.³¹⁶ Under the 1989 Companies Act, DTI can delegate to the Stock Exchange investigatory and prosecutorial powers for simple insider dealing violations.

The DTI sometimes took up to six months to appoint an inspector for insider dealing cases. By the time it checked the inspector's references, and the inspector familiarized himself with the case, the trail had grown cold, the perpetrators had fled the jurisdiction, and the gathering of evidence for a successful criminal prosecution was made more difficult. The DTI's choice of

than under the Company Securities (Insider Dealing) Act. It suggested a system of plea bargaining whereby an individual who was investigated, and confronted with a statement of facts, could, if he did not dispute them, pay a fine. The Report suggested introducing sanctions which would have a lower standard of proof and that DTI expedite the appointment of investigations and completion of investigations. *Reforms Urged*, *supra* note 221, at 28, col. 1.

311. F.S.A., *supra* note 1, at § 48.

312. Lever, *DTI Error Limits Scope for Insider Inquiries*, *The Times* (London,) Aug. 1, 1988, at 19, col. 2. In *R. v. Secretary of State for Trade and Industry, ex parte* (1988), the court held that § 105 of the Financial Services Act powers could not be exercised in relation to any information relating to business that occurred prior to the effective date of the F.S.A. See Barister, *Investigation Powers are not Retrospective*, *Fin. Times*, Dec. 2, 1988, at 21, col. 3.

313. Companies Act 1985, ch. 6, §§ 431, 442, 447 (1985). Difficulties of DTI's patrol of corporate law violations led to Parliament granting the Department more flexible powers of inspection and investigation. Companies Act, 1989, ch. 40, §§ 55, 57, 82-83.

314. *Id.* § 423.

315. Queens Counsel are experienced barristers who can be appointed to represent the government in certain matters.

316. B. RIDER, *supra* note 241, at 117.

inspectors probably delayed the investigation further. Because of their ongoing practices, inspectors' investigatorial activities for the DTI might not be their greatest priority.³¹⁷

The DTI's problems in investigating and prosecuting insider dealing violations were caused by insufficient staff, the broad responsibilities of the Department, and a lack of investigatory zeal throughout the organization. Overlaying these problems, the Department was never able to build up a reservoir of experienced inspectors or a DTI staff with cumulative experience in the investigation of insider dealing. Nor has the agency been able to make good public use of its reports when issued. It has allowed inspectors to criticize named individuals but only in moderate terms.³¹⁸ Some reports did not attribute blame for wrongdoing. Others were unpublished for fear of hampering a criminal investigation or concern with defaming parties mentioned. Publicity about investigation results is not only a deterrence to fraud, it may be good public relations.

c. Judicial Barriers to Enforcement — Process, Inexperience and Conservatism

It has been surprisingly difficult to obtain convictions under the Insider Dealing Act when there have been prosecutions.³¹⁹ In part, this is due to the statute's failure to define specifically the nature of the offense. Each violation, at least in the early cases, seemed particularly factually oriented. Second, in the absence of a civil remedy, the prosecution must meet the criminal burden of proof beyond a reasonable doubt. It has been difficult to convince courts that such evidence produced meets that standard. Nor have defendants been willing to plea bargain, for several reasons. The first is that there is not yet broad agreement that insider dealing is really wrong and should therefore be punished by a criminal conviction. Second, the highly publicized failures to achieve successful prosecutions encourage a spirited defense.

This attitude carries over to the judiciary. When there have been convictions, the penalties have been less than the profits made or losses avoided by the trades, making the punishment more a cost of doing business to the defendant than a deterrent to others.³²⁰

317. The House of Commons Committee recommended that inspectors appointed by the DTI devote 75% of their time to the inquiry. *Reforms Urged*, *supra* note 221, at 28, col. 6.

318. *Id.*

319. *See supra* notes 300-01.

320. In the United States, the traditional remedy for civil or administrative actions was disgorgement of profits. In 1984, Congress increased the penalties for violating the 1934 Securities Exchange Act or its rules. The Insider Trading Sanctions Act of 1984, 15 U.S.C.A. 78u(d)(2)(A), provides for trebling the profits gained or losses avoided by the defendant. Criminal penalties were increased from \$10,000 to \$100,000. In 1988, the Insider Trading and Securities Fraud Enforcement Act made employers and controlling persons liable for the acts of their employees if the controlling person knew or acted in reckless disregard of the fact that the controlled person was likely to engage in illegal insider dealing and failed to take adequate precautions to prevent the prohibited conduct from taking place. 15 U.S.C.A. § 78U-1(b)(1) (West Supp. 1990). For controlling persons, the treble damages penalty was not to exceed the greater

A problem in securing insider dealing convictions has been that cases have been brought in the Crown Courts, lower courts unfamiliar with the complex cases of commercial fraud. In the United States, violations of the federal securities laws must be tried in federal district court.³²¹ Most of the insider dealing cases have been tried in the Southern District of New York which has developed substantial experience in these complex cases. In the United Kingdom, however, the lack of cumulative experience in the investigation, prosecution, and adjudication of commercial crimes remains a hindrance to effective enforcement. The Roskill Report recommended that a special Fraud Trials Tribunal be created to handle complex cases of commercial fraud. This would ease judicial insecurities over dealing with these types of cases.

Another cause for the luke-warm judicial reception of the insider trading cases, which is much more difficult to document, is the innate conservatism of the judiciary. This conservatism is exhibited by members of local courts dealing with a vague criminal statute involving a totally new crime. These judges may have been reluctant to interpret this new crime expansively without direction from higher courts, particularly when asked to force a journalist to divulge sources and waive a privilege. The rigidity of the statutory remedies also may have contributed to the strict interpretation of the statute. Civil or administrative options, if available, can weed out some of the closer cases.

Lower courts that are unfamiliar with the statute have not favorably responded to its nuances. In the first case interpreting the Insider Dealing Act, the issue was whether someone who traded upon non-public price-sensitive information received from another was a tippee, in violation of the statute, when the source volunteered the information, as opposed to the receiver "obtaining" it through his own efforts. Did the word "obtained" in section 1(3) of the Insider Dealing Act include information freely offered?³²² A businessman, Brian Fisher, was informed by a merchant bank with a relationship to a company involved in a takeover that a takeover bid had been agreed upon and that the information was confidential. Fisher then purchased six thousand of the company's shares on the stock exchange, sold them after the information became public, and made a profit of three thousand pounds. The lower court acquitted the defendant, but the Court of Appeal reversed and the House of Lords affirmed the reversal. Whether the information was solicited or received did not increase or decrease the undesirability of making use of it. The appellate decision reinforced the statute.

What is disturbing about judicial interpretations of the insider dealing statute is the lower courts' restrictive view of its enforcement powers. Another crown court decision, fortunately also reversed, involved a journalist

of one million dollars or three times the profits gained or losses avoided. 15 U.S.C.A. § 78T-1(a) (West Supp. 1990).

321. See e.g., Securities Exchange Act of 1935, § 27, 15 U.S.C.A. 78aa (West Supp. 1990); Securities Act of 1933, § 22(a), 15 U.S.C.A. § 77u(a) (West Supp. 1990).

322. Fin. Times, April 18, 1989, at 12, col. 5.

who refused to assist an insider dealing inquiry on grounds of a journalist's privilege.³²³ The journalist published articles in which he accurately forecasted the result of inquiries into two takeover bids conducted by the Monopolies and Mergers Commission and the Office of Fair Trading.³²⁴ It was highly probable that the information had been leaked by official sources within those offices. The information also was given to individuals who used it for insider dealing.

The Secretary of State appointed inspectors to investigate the suspected leaks which were violations of the Insider Dealing statute.³²⁵ The journalist, who knew that the information was price-sensitive, declined the inspectors' request to give evidence on grounds of a journalist's privilege not to disclose his sources.³²⁶ Following the refusal, the inspectors referred the matter to the High Court to determine whether Warner violated the Contempt of Court Act.³²⁷

The High Court ruled that the inspectors had not proven that the need for Warner's testimony to prevent a crime outweighed the public interest in protecting his source.³²⁸ If this decision had been affirmed, investigations of insider dealing and multilateral cooperation would have been hindered. However, the Court of Appeal reversed³²⁹ and the House of Lords affirmed the reversal.³³⁰ Nevertheless, unless the lower courts become more responsive to investigations, insider trading enforcement will be hindered.

d. Deregulation

Deregulation integrated functionally segmented sectors of the financial services industry to enable British financial services firms to compete in global capital markets. Two important political goals of the Big Bang were to increase competition, which in turn would lower the transaction costs of trading securities, and to attract the small investor to the securities markets.³³¹ "Peoples Capitalism" required a belief by the small investor in the fairness of

323. *In re an Inquiry Under the Company Securities (Insider Dealing) Act 1985*, 2 W.L.R. 33 (C.A. 1988).

324. *Id.* at 38-39.

325. F.S.A., *supra* note 1, § 177(3).

326. *In re Inquiry* 2 W.L.R. at 39 (1988).

327. *Id.* at 40. This referral was pursuant to F.S.A. § 178, the relevant parts provide:

(1) if any person — (a) refuses to comply with any request under subsection (3) of section 177 above; or (b) refuses to answer any questions put to him by the inspectors appointed under that section with respect to any matter relevant for establishing whether or not any suspected contravention has occurred, the inspectors may certify that fact in writing to the court and the court may inquire into the case.

(2) If, after hearing any witness who may be produced against or on behalf of the alleged offender and any statement which may be offered in defense, the court is satisfied that he did without reasonable excuse refuse to comply with such a request or answer any such question, the court may — punish him in like manner as if he had been guilty of contempt of the court; . .

328. *In re Inquiry* 2 W.L.R. at 45-46 (1988).

329. *Id.* at 57.

330. *Id.* at 71.

331. J. PLENDER & P. WALLACE, *THE SQUARE MILE* 18-20, 219-22 (1985).

the marketplace, that they would not be discriminated against or taken advantage of because of the size of their holdings or unequal access to information. The markets' legitimacy and integrity would be enhanced by improving business practices, by increasing disclosure to equalize information disparities, and by creating greater transparency in trading to aid enforcement.

The Big Bang mandated new standards of behavior which were backed up by criminal penalties. However, it is one thing to legislate a change in morality; it is quite another to change the business culture to create new norms and patterns of behavior. As noted earlier, because of the computerization and technological developments nurtured by the Big Bang, for the first time the stock market tape was transparent so that all trading could be quickly traced.³³² Yet, even with a new capacity to detect improper dealing, notorious scandals continued to occur.

One may attribute the persistence of insider dealing to the widespread belief that it is really a victimless crime. Other types of securities violations such as market manipulation, clearly recognized as illegal in the United States,³³³ are considered merely venial wrongs and assumed to be widespread. Market manipulation is a violation of the F.S.A.³³⁴ However, it did not become illegal until 1986 and is considered by stock brokers to be an acceptable trading practice between professionals who should be able to protect themselves.³³⁵

In November 1990, the Stock Exchange investigated suspected "bear raids" on approximately one dozen companies³³⁶. Despite the widespread perception that "bear raids" exist, there has been only one prosecution and the penalty was modest: a 1,150 pound fine and five year prohibition of serving as a board member.³³⁷

Undoubtedly insider trading and breaches of Chinese Walls occur regularly. It is insufficient for firms merely to have policies requiring Chinese Walls or rules against the misuse of material non-public information. They must also have the means and the desire to enforce such strictures. In the United States, doubts about the effectiveness of firms' Chinese Walls led to an amendment of the Securities Exchange Act to expand exposure to civil liability for insider trading beyond the violators themselves, to securities firms and

332. Prior to the Big Bang, trades were reported the following day, but without the time of the transaction. Kohut, *U.K. Reforms Ensure Probity — Stock Exchange Chief*, REUTERS MONEY REP., Jan. 27, 1987.

333. Securities Exchange Act of 1934, §§ 9, 10(b), 15 U.S.C.A. §§ 78i, 78j(b) (West Supp. 1990).

334. *Id.* § 47(2).

335. Hudson, *London Exchange Probes 'Suspicious Dealings' in Stocks That May Have Been Bear Raid Targets*, Wall St. J., Nov. 7, 1990, at C12, col. 2.

336. *Id.* A "bear raid" occurs when a speculator spreads false and malicious rumors about a company in the expectation that the firm's stock will fall. Typically, the speculator sells borrowed stock, known as selling short, in the hope that the stock price will fall. After the market reacts to the false information by pushing down the stock's price, the manipulator purchases the stock to replace the borrowed shares and earns a profit.

337. *Id.*

other controlling persons who knowingly or recklessly fail to take the appropriate measures to prevent insider trading by their employees.³³⁸

6. *Conclusion*

Insider dealing cut to the heart of the viability of the self-regulatory system and the integrity of the marketplace. Because of the government's personal equity plan to encourage more shareholders and the publicity surrounding the Big Bang and the F.S.A., the City itself became more transparent to the public than ever before. Insider dealing destroys the investing public's faith that the market presents a level playing field. If the market is fixed, the public will shun investment in securities. The insider dealing scandals were shocking because of the notoriety of those involved. These individuals were at the heart of the City, or civil servants thought to be above reproach. The whole structure of regulation trembled. Even some Tories concluded that a statutory commission would be needed.³³⁹

Insider dealing becomes the moral measure of the new framework's effectiveness. The admitted difficulties of prosecution of insider trading violations means that such improper transactions will decline only when there is a consensus that it is wrong, a fear that one engaging in such activity will be discovered, and prosecution that is effective and timely. Given the present enforcement system, it is uncertain that such a goal can be reached.

C. *Multilateral Cooperation*

Because of the transnational nature of securities fraud and the need to procure evidence from foreign nations and regulators, there has been a movement, spearheaded by the U.S. Securities and Exchange Commission, to foster cooperation between regulators through Memoranda of Understanding (MOU). These memoranda grant a regulatory authority, such as the DTI, access to a foreign regulator's information about an investor or suspect, or to information the foreign regulator could obtain through "best efforts." Traditionally, foreign regulators have been less than cooperative with one another. The DTI once refused an SEC request for a telephone number!³⁴⁰ In September 1986, the United Kingdom and the United States signed such an MOU.³⁴¹

The MOU provides that requests for information must relate to the prevention of insider dealing, fraudulent securities dealing, or market manipulation.³⁴² Information requested may be refused when it is held by the DTI in

338. Insider Trading and Securities Fraud Enforcement Act, 15 U.S.C.A. § 78u-1(b)(1) (West Supp. 1990).

339. See Stovall, *Economic Spotlight — London Scandals*, Reuters, Jan. 21, 1987.

340. Note, *The British-U.S. Memorandum of Understanding of 1986: Implications After Warner*, 11 *FORDHAM INT'L L.J.* 110, 111 n.5 (1987).

341. MOU, *supra* note 277.

342. *Id.* at ¶ 88,244-245.

a non-securities capacity or on grounds of "public interest."³⁴³ This MOU formalizes previously existing unofficial contracts between the SEC's Division of Enforcement and the Stock Exchange's surveillance department. Because requests for cooperation may be fought by those named, the courts must provide ancillary support for cooperation to be implemented. However, such support may not always be forthcoming. At this point in time, the United Kingdom has been the beneficiary of the U.S.'s efforts for multilateral cooperation.

Perhaps of greatest concern to British regulators has been the insider dealing standards of the European Community come 1992. Despite criticism of the U.K.'s statute and the lack of enforcement, the Insider Dealing Act is the most advanced in Europe. Common insider dealing standards with the Community would be an effective means to improved enforcement. The Government's fear has been that the EC directive would be less practical and effective than the United Kingdom's. A draft proposal on Insider Trading had a broader definition of such dealing and regulated practices than the United Kingdom's.³⁴⁴ In June 1989, the Ambassadors to the EC agreed on a directive against insider trading. They met British concerns by narrowing the definition to trading on the basis of sensitive, non-public information with which traders are closely associated. Some countries, such as Germany, were concerned with the definition of tippee, which has not been prohibited under German law.³⁴⁵ In 1992, insider dealing will be illegal throughout the EC.³⁴⁶

Important for multilateral cooperation is that the directive calls for exchange of information.³⁴⁷ Penalties will continue to vary between countries. Insider trading is a new offense in several EC countries.³⁴⁸ As the British experience demonstrates, it is a long road from the passage of a statute to effective cooperation in law enforcement. The linkages between the United States and United Kingdom financial markets and the efforts of the SEC will assist multilateral cooperation between the two countries. The effectiveness of the European Community's efforts against insider dealing must await an agreement by the financial communities about what practices are impermissible.

V.

THE VIABILITY OF SELF-REGULATION

Self-regulation has been defined by the Bank of England as:

343. See Note, *supra* note 333, at 110; see also Bornstein & Dugger, *supra* note 241, at 413-17 (1987) (analyzing the U.S.-U.K. MOU).

344. See 30 O.J. EUR. COMM. (No. C 153) 8 (1987).

345. Binyon, *EC breakthrough over 1992*, *The Times* (London), June 19, 1989, at 27, col. 1.

346. It will be a criminal offense for the first time in West Germany, Italy, Belgium and Ireland.

347. Draft Directive Art. 8.

348. See Note, *Securities — Insider Trading — The Effects of the New EEC Draft Insider Trading Directive*, 18 GA. J. INT'L. & COMP. L. 119 (1988).

...the realization by a group of individuals or institutions that regulation of their activities is desirable in the common interest, and their acceptance that rules for the performance of functions and of duties should be established and enforced. . .In some cases the enforcement of such standards is entrusted to a committee of a profession or of practitioners in a market. Frequently, however, the enforcement of the regulations may be entrusted to an authority outside the group, which is or becomes customarily recognized and obeyed and which may also become the initiator of new regulations. . .In both cases the system can be described as self-regulation, the first intrinsically so, the second by common consent.³⁴⁹

The English approach traditionally has been to devise methods of regulation which operated along less formalized lines than in other countries, with less emphasis on statutes and more on non-statutory forms of regulation, especially self-regulation.³⁵⁰

Until 1986, the U.K.'s financial markets, except for banks, were regulated by private associations. The Big Bang and the new investor protection framework arose because of concerns that private organizations such as the Stock Exchange no longer adequately protected the public nor reacted to changes in the international environment.³⁵¹ As in the United States, a mixed system of statutory and self-regulation was adopted. In the United States, the tilt was toward the statutory side of the continuum through the creation of an independent government agency, the Securities and Exchange Commission.³⁵² In contrast, the U.K. system is primarily practitioner-based albeit with statutory backing.³⁵³

The advantages of self-regulation are that industry members are close to the problems and weaknesses of the affected industry. They know the texture of the regulated area, as well as its limits, costs, and potential. By making industry practitioners actual participants in the regulatory process, they become more aware of regulation's goals and their own stake in it.³⁵⁴ Thus, practitioner-based regulation is more likely to receive the support of the regulated because industry regulators are deemed more responsive to industry needs than governmental regulation which has other goals. Self-regulation is also considered less costly than governmental regulation. It offers speed, flexibility, and informality. In the context of enforcement, sanctions are quick,

349. Report of the Committee to Review the Functioning of Financial Institutions (the Wilson Report Second State Evidence, Cmnd. 7937, 89 ¶ 5 (1977)).

350. *Id.* at ¶ 1072.

351. H. McRAE & F. CAIRNCROSS, *CAPITAL CITY* 137, 157-60 (rev. ed. 1985).

352. Over the last sixty years the SEC has exerted increasing authority over the self-regulatory organizations: the securities exchanges and the National Association of Securities Dealers. See Securities Act Amendments of 1975, Pub. L. No. 94-29, 89 STAT. 146 (1976) (added oversight responsibilities to the Commission's powers under § 19 of the Securities Exchange Act).

353. WHITE PAPER, *supra* note 2, at §§ 5.1-5.2.

354. SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H. R. Doc. 95, 88th Cong. 1st Sess. pt. 5 at 197-98.

private, and effective, because one's reputation among peers is more important than the penalty, and discipline is based upon consent rather than statute.³⁵⁵

Moreover, a self-regulating system can better address the ethical practices of an industry than governmental regulation, which by nature, proceeds through law and rule-making to determine legal conduct. It may be impossible for government to raise industry morals.

Self-regulation provides industry members with the incentive to cooperate, to develop shared norms of behavior for the common good of the industry, and to aspire to higher ethical behavior. Norms and rules developed by practitioners may be more psychologically acceptable to industry. The responsibility of participating in a system of self-regulation produces greater professional integrity and discipline and voluntary obedience.³⁵⁶

Self-regulation may be an idea whose time has come and gone. In sheltered, smaller industries as the U.K.'s financial services sector once was, where regulators and members are known to one another, the fear of sanctions for violating ethical norms was an effective deterrent. In the large anonymous financial markets today, industry regulators are as distant as government civil servants. The ethical and aspirational advantages of self-regulatory systems may not hold if the community is too diverse. The fear of direct regulation serves to energize self-regulatory bodies and divert them from a natural predisposition to serve a trade association function. If the self-regulatory principle is unsuccessful, one can envision the SIB converted into or replaced by a statutory body and the SROs occupying a much diminished regulatory role.

The success of the principle of self-regulation can be seen in the history of the U.K.'s Panel on Takeovers and Chargers. The limits of the concept and its viability as a regulatory tool in the future is presented in the Blue Arrow affair, where the norms of behavior seem to have broken down.

A. *The Panel on Takeovers and Mergers: A Case Study*

The United Kingdom is unique in its regulation of mergers and takeovers, for there are no statutes which guide the procedures when a takeover situation comes into play. The most successful and effective self-regulatory agency is the Panel on Takeovers and Mergers (the Panel), which supervises the *City Code on Takeovers and Mergers*, a set of rules designed to establish fair play in the market.

Once, the takeover Panel was the prototype of effective self-regulation. However, times have changed. Deregulation, international competition, and the participation of individuals and firms who did not share the norms that underlay self-regulatory principles have placed the Panel's future into doubt.

355. See L. GOWER, *supra* note 277.

356. SPECIAL STUDY, *supra* note 152, at 694, pt. 4; cf., WHITE PAPER, *supra* note 2, at 6, 13.

The United Kingdom has responded by giving the Panel statutory backing and forcing it to adopt more legalistic procedures. Doubts remain as to whether the Panel can be an effective self-regulating body in the future, a question that reflects upon the whole framework of investor protection.

The origins of the Panel and the Code date to the post-war period when the number of companies with such attributes as underutilized assets and insufficient management made them easy targets for corporate raiders. There was a perceived need to achieve an orderly market where shareholders received a fair deal, yet the market itself was allowed to work. In 1959, a working party of City institutions was convened by the Bank of England. This group laid down rules of fair play, *Notes on Amalgamation of British Businesses*, which were inadequate to control inappropriate practices.

Another working party was created in 1968, and this one resulted in the first City Code and the Panel on Takeovers and Mergers, the latter a full-time body to supervise the principles in the Code.³⁵⁷ The Panel is not a regulatory body with formal statutory authority. In 1969, the Panel arranged with the Bank of England and the DTI a guarantee that the DTI would use the sanctions available to it if the Panel so requested.

The City Code on Takeovers and Mergers contains ten general principles and thirty-eight rules supplemented and explained by practice notes. The principal concern of the Code is the protection of shareholders. In addition, since 1981, the Code includes *Rules Governing Substantial Acquisitions of Shares* to prevent "dawn raids," the speedy, organized acquisition of shares in a target company.³⁵⁸

The Panel's effectiveness harked back to the original concept of self-regulation of the City, a shared sense of values and behavior.³⁵⁹ Anyone who desired to engage in mergers and takeovers had to abide by the City rules or face banishment from the resources of the City establishment. All offerors had to go through a few City institutions that handled the paper work and issued the necessary documents. These institutions, merchant banks, are few in number and accepted the principles of the Code. In addition, they are watched by the Bank of England. Section 14 of the Prevention of Fraud (Investments)³⁶⁰ virtually obligated all tender offers to be conducted through licensed dealers, members of the Stock Exchange, or exempted dealers. All of these bodies adhered to the principles of the Code. This tightly knit group made it impossible for outsiders to conduct a takeover without using responsible local intermediaries.

357. See generally DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y.U. L. REV. 945 (1983); M.V. BLANK & A.L. GREYSTOKE, *WEINBERG AND BANK ON TAKEOVERS AND MERGERS* (4th ed. 1979).

358. L. GOWER, *GOWER'S PRINCIPLES OF MODERN COMPANY LAW* 697-8 (4th ed. 1979 & Supp. 1988).

359. H. MCRAE & F. CAIRNCROSS, *supra* note 351, at 153-54.

360. F.S.A., *supra* note 1, § 14.

Sanctions available to the Panel did not have legal backing, but had the power of moral persuasion, and the bidders realized that the voluntary self-regulated code of principles was backed by access to City financial resources. Failure to follow the Code meant that one could not use the facilities of the securities markets, that one might be shunned by other companies, and that needed capital could not be obtained.³⁶¹ Work of the Panel was conducted informally and behind closed doors. It would review documents in advance and worked via telephone rather than through formal published opinions.

While the effectiveness of the Panel has been criticized from time to time, it has survived for twenty years and has reviewed approximately five thousand takeovers.³⁶² The Panel on Takeovers and Mergers has often been cited as a successful self-regulating organization. In its original conception, the Panel was very much a City institution, exemplary of how self-regulation should work. Its sanctions were based upon censure and persuasion. Its decisions were swifter than any statutory body and were without appeal. In contrast to the SIB, which has had so much trouble recruiting in the City, the director general of the Panel and two-thirds of its fifteen-person staff are seconded from City institutions, the Bank of England, or Whitehall.³⁶³ However, the original conception of the Panel as a purely self-regulatory body based upon the consensus of City institutions is a thing of the past.

The globalization of securities markets and mergers and takeovers has made the private future of the Panel uncertain. The legalization of the tender offer process has resulted in legal appeals of Panel decisions.³⁶⁴ While the Panel has been supported by the courts, it has been forced to become more formal in its rules and proceedings, and to seek indirect support under the F.S.A.. Pressures upon the Panel have led to a formalization of its procedures, particularly in light of the Guinness affair and the Datafin case³⁶⁵ which held that the Panel was a public law body whose decisions could be scrutinized by the courts and reversed if they violated natural justice. The judgments of the Panel are now published, and resemble judicial opinions in style and length. Since the Guinness affair, when most of the parties seemed to play loosely with the rules of the City Code, the Panel has been under pressure to resist the logical step of placing it under the aegis of the SIB.

With the internationalization of mergers, and particularly through the use of American tender offer techniques, such as the tactic of running into court, the Panel has been criticized for an inability to deal with breaches of the Code and an insufficiency in this new climate.³⁶⁶ In the past, the Panel's

361. M. CLARKE, *supra* note 206, at 109-112.

362. Brown, *Watchdog Learns to Bite*, *The Times* (London), Jun. 30, 1988, at 21, col. 1.

363. *Ex parte Datafin*, 1 All E.R. 564 (C.A. 1987); *ex parte Guinness*, 1 All E.R. 509 (C.A. 1988).

364. Brown, *supra* note 362.

365. *Ex parte Datafin*, 1 All E.R. 564 (C.A. 1987).

366. *Guinness, Panel Beating*, *ECONOMIST*, Jan. 31, 1987, at 72.

greatest threat was to bar violators from access to British capital. This is not much of a penalty to foreign firms with other resources.³⁶⁷

In light of Guinness, the DTI and the Bank of England commissioned a study of the Panel's operations in January 1987. The study concluded that the Panel's role has changed from that of essentially an arbitrator to one of investigator and enforcer. This has necessitated closer relationships to the SIB and the DTI, and the formalization of its role within the new investor protection framework. The Panel has maintained a delicate balance of being outside the framework yet able to use the sanctioning powers of the SIB and recognized bodies. Stricter takeover rules have been promulgated; offerors have to declare their interest and trading activities at much lower thresholds, rules require greater disclosure from investor groups acting in concert, and nominee companies have to disclose their owners.³⁶⁸

The SIB issued a rule which called for "cold shouldering" of those listed by the Panel and for firms to assist Panel investigations by providing information.³⁶⁹ The SIB has encouraged the recognized bodies to adopt similar rules.³⁷⁰ As the Panel has no statutory power nor even the contract-based authority of the recognized bodies, *vis-a-vis* its members, it can neither subpoena documents nor force attendance at hearings. However, individuals who are members of a recognized body are now subject to Panel discipline.

When a person has been named by the Panel, or a firm has reason to believe that an individual has not complied with U.K. practice and standards in takeovers, the firm may not act on behalf of such a person in connection with a takeover and must comply with any request for information from the Panel. The government also made an order granting the Panel the right to privileged information pursuant to section 180 and the DTI's investigative powers.³⁷¹

A leading QC commercial lawyer, Robert Alexander, later Lord Alexander, became chairman of the Panel and gave it a more authoritative and public voice. The Panel will be under increasing stress in the future. Though it has maintained its dependence, it has moved towards the statutory model. Its ability to continue effectively is intertwined with the success of the recognized bodies and the SIB. Looming in its future is the European Community's approach to changes in corporate control within the single European market.

B. The Limits of Self-Regulatory Enforcement: The Blue Arrow Affair

Self-regulation is based upon the belief that most individuals and firms strive to uphold the norms of business practice. These standards are set by

367. See M. CLARKE, *supra* note 206, at 111.

368. Lohr, *Tough British Takeover Rules*, N.Y. Times, Feb. 2, 1987, at D3, col. 1.

369. SIB CONDUCT OF INVESTIGATION RULES, *supra* note 122, ch. III, rule 2.12.

370. TSA Rules, *supra* note 269, Rule 580.

371. Dickson, *Takeover Panel Given Greater Powers Following City Scandals*, Fin. Times, May 12, 1987, at 1, col. 3.

the leading firms — the establishment. Enforcement problems are expected to be directed at those firms on the fringe. Self-regulation is also grounded in the belief that the spirit of the law is more important than its letter. But what if firms at the center ignore the standards? That brings into question the whole basis of regulation.

In July 1989, the DTI charged that National Westminster Bank,³⁷² the United Kingdom's second largest in size of assets, through its merchant banking subsidiary misled the Bank of England, the International Stock Exchange, and the public, in the course of an underwriting of stock of the Blue Arrow corporation. The history of the Blue Arrow affair challenges the theory of self-regulation and suggests that the Big Bang has created institutions of unmanageable size.

Blue Arrow involved deliberate evasion of the disclosure requirements of the Companies Acts, misleading the public and supervisors of the nature of placement arrangements, rigging of the market and manipulating the price of shares, lying to the Bank of England about legal advice received, failure by a major bank to supervise its employees or to get to the truth of a subsidiary's misdeeds, and failure of compliance officers to concern themselves closely enough with the facts or the spirit of the rules. The scandal resulted in the destruction of the careers of over a score of individuals of varying degrees of guilt, and overall, a severe gouging of the concept of City self-regulation.

The Blue Arrow affair began in the summer of 1987 when Blue Arrow Corporation commenced a bid for Manpower, the United States' largest employment agency. In the run up to the tender offer, Blue Arrow began to purchase Manpower shares. Stealth is an important though sometimes impermissible tactic for an offeror in a takeover. Under the International Stock Exchange's rules,³⁷³ Blue Arrow was required to disclose these purchases if they were worth more than five percent of its capital. Such disclosure, however, would have disrupted Blue Arrow's takeover ambitions. County NatWest (CNW), the investment banking subsidiary of National Westminster Bank (NatWest), was the advisor and underwriter of a new stock issue for Blue Arrow which would raise capital to purchase Manpower.³⁷⁴

372. National Westminster (NatWest) has \$178.5 billion in assets making it larger than any U.S. bank holding corporation except Citicorp. Natwest is the leading bank in market capitalization. Greenhouse, *NatWest's Chairman Resigns*, N.Y. Times, July 26, 1989, at D1, col. 6.

373. COUNCIL OF THE STOCK EXCHANGE, *ADMISSION OF SECURITIES TO LISTING* (Looseleaf), § 6.08 (2d ed. 1985).

374. The advice of County NatWest's compliance office was "Won't disclose. Announce in two weeks. Worse case = rapped on knuckles. No chance of shares being delisted." The corporation unsuccessfully sought a waiver from the exchange. Then, it launched an 837 million pound bid for Manpower through a new stock issue. The tender offer and rights issue was particularly important to CNW and its parents, because it would demonstrate that CNW was a major player in merchant banking. NatWest provided an 837 million pound bridge loan. Dept. Trade & Industry, County NatWest Rpt. (1989) excerpted in *Damning Chronicle of the Failure of a Huge City Deal*, Fin. Times, July, 21, 1989, at 10, col. 1; Fleet, *The Path of Blue Arrow Affair Targets Post Big Bang Banking*, The Times (London), July 22, 1988, at 19, col. 5; County NatWest: *Anatomy of a Cover-up*, Economist 78 (Jan. 28, 1969).

There was inadequate interest in the new issue. Only thirty-eight percent of the new shares were taken up. The leading underwriters, CNW, Phillips & Drew, a subsidiary of UBS, a Swiss bank, and Dillon Reed, decided to purchase an additional ten percent themselves, which saved the issue. Although the deadline for purchases had expired, Lloyds Bank, the registrars, allowed the extra purchases. This enabled the underwriters to announce that nearly half of the shares had been sold. Then, the lead underwriters attempted to sell the remainder of the issue. Only seventy-one percent of the total issue could be placed.

On September 28, 1987, CNW issued a press release stating that all of the shares had been sold on the market at a price above their issue price. It then parked its remaining Blue Arrow shares, placing just under five percent of each (because five percent would have required disclosure) in its corporate advisory department. Another block was placed with County NatWest Securities, and a third with Phillips & Drew under a profit and loss sharing arrangement.

Officials in CNW rationalized that because the shares were acquired in the course of a market making business, the share parking did not have to be disclosed pursuant to section 209 of the Companies Act. Section 209 allows market makers' holdings to be exempt from a group's disclosure requirements if they are held in the normal course of business.³⁷⁵ This was a very tenuous legal argument, for Blue Arrow stock had been parked in order to disguise the failure of the underwriting issue. The Bank of England had been informed in August of the amount of shares underwritten by CNW. On September 30, 1987, the Bank was misled when a CNW representative stated that CNW had taken "double and treble" legal advice as to the bank's legal position.

To maintain Blue Arrow's share price, on October first several officials of CNW purchased between five hundred and one thousand shares each. This was permissible under CNW internal procedures. However, the executives were in possession of the price-sensitive, non-public information that Blue Arrow was about to appoint a new chief executive. CNW officials had second thoughts and told the executives to unwind the purchases. Thereafter, CNW purchased options to hedge its large holding. The market was unaware that so much Blue Arrow stock was held by CNW, a fact which, if known, would have depressed the price of the options and the stock.

On October 2, Phillips & Drew placed a tombstone advertisement in the *Financial Times* announcing that it had successfully placed shares not taken up by existing shareholders at a premium. At best, this was a misleading statement since CNW and Phillips & Drew had retained 77,000 shares because they couldn't sell them. The whole affair might have remained undetected, if not for the market break of October 19, 1987, which halved the

375. *Companies Act*, 1985, ch. 6, § 209.

price of Blue Arrow shares and left CNW with a potential eighty million pound loss. Such a loss could not be concealed.

In December, the NatWest board was informed of the entire sequence of events, because CNW was seeking an eighty million pound injection of capital from its parent. In that month, CNW made a public announcement of its holdings in Blue Arrow, but did not disclose its Blue Arrow stock held by agreement with Phillips & Drew. On February 23, 1988, CNW's chairman and chief executive resigned, as CNW reported a loss of 116 million pounds. Three days later, Natwest launched an internal inquiry that was transmitted to the Bank of England, which then reported problems to DTI.

The DTI inquiry, published in July 1989, concluded that the market had been misled, that provisions of the Companies Acts had not been complied with, and that there had been no justification for what had happened. The report blamed the corporate finance departments of Phillips & Drew, CNW, and NatWest because in conducting the internal inquiry, the bank never asked the proper questions. The report criticized three executive directors at NatWest for their part in the muddled internal investigation. None had the experience to examine critically what CNW executives told them, and they accepted too readily what they were told. The DTI report was passed on to the Bank of England and the SFO.³⁷⁶

The Bank of England wanted a proper response from NatWest, which it very shortly received. The Bank was furious that it had been misled. It responded by sending letters questioning whether some of the individuals involved were fit and proper persons to be involved in banking. That ended a number of City careers. The Bank has the power to blacklist individuals it feels are not "fit and proper."³⁷⁷

In the aftermath of the Blue Arrow affair, the Chairman and three directors of National Westminster's board resigned, as did several of the principle players involved in the deception. The Chairman of NatWest, Lord Boardman, stepped down a few months before his retirement and was replaced by Lord Alexander, the forceful head of the Takeover Panel and the first NatWest head without a banking background. Although the directors were not involved in the Blue Arrow scheme, they had not inquired with sufficient diligence when the scheme was uncovered within the bank and their conduct had fallen below what was expected of responsible executives.

The Bank of England forced the resignation of Jonathan Cohen as Vice Chairman of Charterhouse Bank. Cohen, who had been chief executive of

376. Department of Trade and Industry, *County NatWest Limited/County NatWest Securities Limited* (1989). For an account of the Blue Arrow Affair and summaries of the report, see *Fin. Times*, July 21, 1989, at 10, col. 1. A series of articles in the *Economist* first brought the Blue Arrow affair to light. See *With a Little Help from NatWest's Friends*, *ECONOMIST*, Jan. 7, 1989, at 65; *County NatWest: Anatomy of a Cover-up*, *ECONOMIST*, Jan. 28, 1989, at 78; *The Tarnishing of NatWest*, *ECONOMIST*, Jan. 28, 1989, at 14.

377. *Top Charterhouse Man Goes in Blue Arrow Affair*, *The Times* (London), Aug. 3, 1989, at 21, col. 2.

CNW during the Blue Arrow underwriting, had been cleared of wrongdoing by the DTI inspectors. The Securities Association brought disciplinary action against twenty-four individuals named in the DTI report and others. Such action could have led to a finding that the individuals involved were not fit and proper, and to the discipline of the firms that those named are now associated with and of CNW and Phillips & Drew.³⁷⁸ Prior to such a determination, most of the principals resigned or were forced out of their positions.

The SFO brought criminal indictments against CNW, Phillips & Drew, and eleven individuals, some of whom had been exonerated in the DTI report. NatWest and Phillips & Drew later offered compensation to investors who had purchased shares after the announcement of the "successful" placement and before October 26, 1987 when the shares sank to their lowest price. Most purchasers had been institutions.³⁷⁹

The scope of the deception explains the rapidity of the response by the Bank of England and the Securities Association. Clearly, self-regulation did not work. Unknown is whether the Blue Arrow reflects normal business practice in the City or was atypical, an example of financial conglomeration gone awry. Was Blue Arrow a demonstration of size and complexity of an institution exceeding the ability of managers to control it? The Board of Directors may not be focused sufficiently to monitor the activities of a diffuse financial empire. Before Blue Arrow, NatWest had the reputation as Britain's best managed bank.³⁸⁰ If compliance and monitoring procedures were inadequate there, what were they like at other firms? Self-regulation requires effective compliance procedures even in times of a bear market. Bryan Gould, Labor party spokesman for trade and industry, said that the Bank of England was too close to the people it regulated and too slow and soft in acting. "The raised eyebrow is no longer enough to deal with the old boys and the fly boys."³⁸¹

Gould is incorrect. While there was delay in uncovering the wrongdoing, and the self-regulatory concept has been questioned because NatWest seemed more concerned with dampening a spreading fire than with getting to the truth, the public denunciation of NatWest is unparalleled. Formerly, if a DTI report had been commissioned, it would have taken years to complete. Disciplinary action would have been meted out quietly, and only those in the City establishment would have known about it. "...[A]ny dirty linen would

378. Feltham, *TSA Considers Action Against 24 in County NatWest Affair*, *Fin. Times*, July 22, 1989, at 17, col. 2. UBS Phillips & Drew was ordered by TSA to introduce broad changes in the way it ran its Compliance Department. Waters, *Changes Demanded at UBS Phillips & Drew*, *Fin. Times*, Nov. 15, 1989, at 20, col. 5.

379. Bennett & Narbrough, *NatWest Offer of 30m Over Blue Arrow*, *The Times* (London), Feb. 15, 1990, at 25, col. 2.

380. Riley, *The High Price of Banking Error*, *Fin. Times*, July 27, 1989, at 20, col. 3.

381. *Labour Attacks City Self-regulation*, *Fin. Times*, Jul. 27, 1989, at 8, col. 5.

have been quietly bleached. Not now. . .the dirty linen. . .was hung up for all to see."³⁸²

The impact of Blue Arrow goes beyond the careers of those destroyed or even the reputation of National Westminster Bank. It reaches to the very heart of the concept of self-regulation. Given the relatively blasé attitude toward stretching and ignoring the rules, one is left with the feeling that such practices uncovered in Blue Arrow are widespread. If evasion of the rules of the Companies Acts and the Stock Exchange are a matter of course, the new regime is based upon a very flawed premise. The inefficiency of internal controls, the willingness of compliance officers to turn the other way when large amounts of money are involved, and the inability of internal investigations to shed more light than smoke are all profoundly disturbing. The after-the-fact purge of the participants by the Bank of England and the Securities Association cannot hide the fact that something is seriously awry. Blue Arrow undermines some of the rationale behind the mergers of banks and other financial services businesses.

Blue Arrow also revealed differences between the securities and banking businesses and how securities subsidiaries can pose new risks to their banking parents. Whereas traditional banking has an orderliness and predictability in earnings and risk, this is absent in the securities business, which may not be understood by banking regulators. The difference in experience and approach to securities risk and the separation of securities from banking regulation is in sharp contrast to conventional European regulation where banks have long been engaged in the securities business.³⁸³

One of the fundamental beliefs of self-regulation is that the spirit as well as the letter of the rules must be followed. In Blue Arrow, the only concern was whether the action taken was legal, or if not, whether a technical legal argument could be made in favor of it. For all brokers, the willingness to cut corners in the face of financial loss is tempting in the difficult times of the post-October 1987 environment. If other firms facing losses engage in similar practices, the future of the self-regulatory concept looks bleak indeed.³⁸⁴

However, the Blue Arrow affair, repeated insider dealing scandals, and increased investigation of market manipulation may indicate not that fraud is increasing, but that detection is better. While the framework of investor protection has introduced new rules to reflect new financial patterns, they have been grafted onto norms of behavior that no longer exist and perhaps, cannot, given new financial realities.

Integrated financial services firms require substantially more capital to conduct business, and there are substantial costs to compliance with the self-

382. *The City After County*, *ECONOMIST*, July 29, 1989, at 17.

383. *Lascelles, Order in the Marketplace*, *Fin. Times*, Sept. 25, 1989, at 35, col. 3.

384. *The Market Was Misled*, *Fin. Times*, July 21, 1989, at 20, col. 1; Fleet, *The Path of Blue Arrow Affair Targets Post Big Bang Banking*, *The Times* (London), July 22, 1989, at 19, col. 3; Waters, *Eleven Face Charges in UK over Blue Arrow Affair*, *Fin. Times*, Nov. 10, 1989, at 1, col. 8.

regulatory system. It is at the firm level where effective self-regulatory monitoring and enforcement must commence. In a period of contracting business when even well-run firms seem unable to turn a profit, the pressures to cut corners is irresistible.³⁸⁵ It may well be that the norms upon which self-regulation is grounded reflect a financial environment that no longer exists. Can we expect the modern firm, bound by a complex system of rules, to go beyond the letter of the law or to live up to the aspirations of self-regulatory principles?

CONCLUSIONS

Compared to the English structure of enforcement, the American approach is centralized yet flexible, unified, and efficient. The success of the Securities and Exchange Commission's enforcement efforts is due to its centralized enforcement structure combined with substantial in-house capabilities, flexible remedies which increase prosecutorial choice, and good coordination with criminal agencies. Additionally, the SEC has a reputation for vigorous and effective investigation and prosecution which has embellished its reputation among the public and contributed to the creation of an *esprit de corps* within. This in turn has made recruitment easier. The system of continuous disclosure and review by the SEC prevents material omissions and misstatements in corporate documents. The SEC's accordion-like powers, which range from a request for information to referral to the Department of Justice for criminal prosecution, make the Commission an extremely effective enforcement agency. With a staff of 1,898 in fiscal 1986 and a budget of one hundred six million dollars, it is one of the smallest administrative agencies. Each year it returns more to the United States Treasury through its fees and fines than it receives in appropriation.³⁸⁶

Many of the SEC's enforcement remedies are similar to those available under the F.S.A. and other legislation. The difference is that the SEC's enforcement efforts are much more coordinated. SEC enforcement of the securities laws has waxed and waned over its history. There has been a recent movement to increase SEC powers.³⁸⁷ As enforcement problems have become more complex and international, the SEC has been at the forefront of law enforcement, setting a standard that other nations are just starting to

385. The market break in October 1987 ended a five-year bull market in securities in the United Kingdom, the consequences of which were felt years later. In 1989 brokers commissions ran at an annual rate of 650 million pounds, but estimated costs for equity operations were one billion pounds. This led to firms withdrawing from certain markets and to widespread layoffs. See *Shrinking to Fit*, *ECONOMIST*, Nov. 25, 1989, at 86.

386. SEC, 1986 ANNUAL REPORT 2 (1987).

387. The Securities Enforcement and Penny Stock Reform Act of 1990, Pub. L. 101-429, 104 Stat. 931 (codified in scattered sections of 15 U.S.C.) permits the SEC to bypass the federal courts and use the administrative process to levy monetary penalties against SEC-regulated persons (up to \$100,000) and entities (up to \$500,000) if securities laws are violated. Individuals who violate those laws may be suspended.

follow and encouraging multilateral cooperation.³⁸⁸ English enforcement of securities violations is not of the same caliber.

More important than its statutory powers has been the SEC's enforcement tradition, its reputation for effectiveness, and the enthusiasm, even prosecutorial zeal, of its attorneys. Unlike the ramshackle British structure, enforcement efforts are centralized and coordinated. Locating investigation and enforcement completely within the SEC is a more effective way to conduct investigations. Within the Division of Enforcement is a mix of career employees and young attorneys. Those who do not remain for the duration of their professional careers work for the SEC for three to four years and then may move to a law firm with a large securities practice. Although the "revolving door" between industry and government service has been criticized, it does imbue attorneys for the regulated with the norms and expectation of the SEC, which assists compliance and self-regulation when these lawyers work in the industry.

Another strength is the continuous disclosure system required of corporations, which creates an ongoing informal dialogue with the SEC. For instance, under the proxy rules, a corporation must file its proposed proxy statement with the SEC. The corporation has the right to distribute the information to its shareholders ten days after it has been filed with the SEC.³⁸⁹ In fact, the corporation will wait for the SEC to approve. Such informality has been a hallmark of SEC procedures. It is a powerful, yet flexible tool of enforcement.

In contrast to the American experience, British securities enforcement has been marked by overlapping authority and a lack of coordination. Ironically, when United Kingdom securities enforcement was the preserve of the Stock Exchange, informal regulation was the norm. In the words of a senior official at the Securities Association: "club rules were utilized which were very effective among members." Thus, if a member firm could not meet the Stock Exchange's capital requirements, there would be informal inquiries — a telephone call — and the firm would have time to get back in line. There was no public notice, and enforcement was flexible and quick. Will the new SIB rules offer sufficient flexibility for lower level enforcement? A literal reading of the rules suggests that such flexibility may no longer be available to enforcers. For many years the Takeover Panel operated informally. At this point, the English system seems to have lost its informality, but has yet to replace it with something more efficient. So long as securities enforcement is spread over many competing agencies with their own, often different, priorities, prosecution of financial misdealing in the United Kingdom will not approach the SEC's effectiveness.

388. See generally Bornstein & Dugger, *supra* note 187.

389. Securities Exchange Act, rule 14a-5, 17 C.F.R. § 240.14a-5.

Effective enforcement is a bedrock of an investor protection framework. The investigatory and prosecutorial structure has not eliminated insider dealing nor has it created an aura of effectiveness. Deregulation of industry boundaries partly contributed to enforcement problems because multifunctional securities firms created informational problems which "Chinese Walls" in practice do not resolve adequately.³⁹⁰

The failure to obtain convictions of alleged commercial and securities violators publicly demonstrates the greatest weakness in the new system: the muddled organizational structure of overlapping and competing agencies. Despite the lack of prosecutorial success, the *capacity* to uncover fraud and improper conduct has improved because of the increased reporting requirements and the transparency of the markets. The extensive monitoring and reporting requirements are designed to prevent fraud. They create more effective early warning systems. After the enactment of the F.S.A., over six thousand firms were denied authorization; some of these would be unwilling or unable to meet the new standards of behavior. To its great credit, the SIB has reacted swiftly and effectively to instances of wrongdoing.

The two greatest deficiencies in the United Kingdom's enforcement regime are the number of bodies that must become involved to prosecute a violation and the lack of a trained staff to investigate and prosecute. The SROs do not have subpoena powers over third parties who are not members of their organizations. The DTI has shown itself to be completely overwhelmed by its enforcement responsibilities. As long as the police are separated from the SFO, and that office is unsure of the scope of its jurisdiction, it will remain just another layer in the enforcement bureaucracy.

Enforcement efforts will never improve until the duplication and overlap between enforcement bodies is replaced by a unification of the governmental investigatory and prosecutorial units, and improved coordination develops between self-regulatory and governmental bodies.

Given the lack of resources for the prosecution of commercial crime, and the length of time and intensive usage of personnel required to build a case, the most cost efficient approach to enforcement may be the best. That approach calls for centralization in one locus of *all* criminal functions from police investigations to prosecution.

Investigation and enforcement must become more professionalized and must turn away from the *ad hoc* appointment of investigators who lose invaluable time while undergoing recruitment, reference checks, and briefing on the details of the particular case. The SIB-SRO system lacks a reservoir of enforcement expertise. The system has not recruited individuals with prosecutorial mentality or experience.

There is a desperate need for a full-time cadre of mostly career employees to investigate and prosecute securities fraud. Professionalism creates a

390. See N. POSER, *supra* note 3, at § 3.5 (1990) (discussing conflicts of interest).

cumulative expertise which in itself leads to efficient and effective enforcement. Intra-SRO or Recognized Investment Exchange enforcement arms should also have career personnel. An enforcement tradition takes time. The use of career people and centralization of enforcement functions will also breed an esprit and zeal which has been the hallmark of American efforts.

The most sensible future role for the SIB may be as the *Government's* compliance, investigative, and enforcement arm or as a separate, independent governmental agency. Enforcement should be apolitical. The SIB has acted swiftly and vigorously in the exercise of its investigatory powers. It should be solely responsible for the investigation and prosecution of commercial fraud and compliance with reporting requirements. It would still oversee the enforcement efforts of SROs and other authorized bodies who would refer matters to it for prosecution.

To fulfill these new responsibilities the SIB would have a staff of investigators, attorneys, and accountants that would handle cases of commercial fraud from start to finish. It should be awarded full subpoena powers. All enforcement duties should be removed from the DTI, including company law compliance.³⁹¹ Special courts should be created to handle sophisticated commercial fraud. This would allow judges involved in such cases to develop the expertise needed.

As an enforcement agency, the SIB should develop its own cadre of experts and should operate similar to the U.S. Department of Justice's white-collar crime units. A mixture of career and short term employees should be developed. Agency esprit would follow which would nurture a prosecutorial tradition. These recommendations require further legislative action, but the real hurdles would be the political minefields laid down by existing enforcement agencies ranging from the police to the DTI. Effective enforcement requires a whole new beginning.

The Insider Dealing Act should be amended to provide for civil remedies, a common recommendation, and also to define the nature of the wrong. A civil remedy would allow for more flexible, expeditious enforcement requiring a lower burden of proof. More specific definitions of the crime will deter some improper dealing and will stop the threats now facing the statute every time it is challenged in court. The jurisdiction of insider dealing cases should be moved to the High Court, which has greater experience in dealing with the sophisticated concepts involved.

Perhaps the most difficult task will be for the SROs and other recognized bodies to change the business culture so as to develop new norms and patterns of behavior that reflect the mandates of the investor protection system.

391. In contrast to this suggestion, the Labor Party has proposed beefing up the scope of DTI authority and has hinted that the self-regulatory system would be changed to an SEC model. Cf. Atkins, *Labour Sets Out Plans to Curb Insider Deals; City Regulation*, Fin. Times, Dec. 14, 1990, at 8, col. 2.

Creating a new value system takes time. The decline in social and professional standards and sanctions pre-dated, and were a cause of, the introduction of the investor protection system. One must doubt that the current framework will rise to the enforcement tasks of the future. Given its resources, the SIB necessarily will continue to expend undue energy overseeing a complicated system rather than rooting out abuses.

The internationalization of financial services and the growth of commercial fraud can be expected to continue. Unless the enforcement approach is changed, the next boom cycle in the financial markets will demonstrate the system's fatal weaknesses.