1. Introduction

Two related factors that have recently been changing the nature of insider trading enforcement are technology and globalization. The old assumptions about the logical places to look for connections—neighbors, family, co-workers—may not always bear fruit in a world where you can whisper to someone a half a world away and equally easily trade in a market just as far away.¹

The trading of securities in world markets has changed dramatically over the last few decades. Innovations in securitization have led to a vast array of new forms of securities that can be traded and the total value of securities traded has grown tenfold since 1995.² There has also been a significant increase in market capitalizations and the variety of markets for trading securities has multiplied as new trading platforms have appeared. At the same time the larger and more established stock exchanges have expanded into new regions and markets and some have become global conglomerates. New players in the markets, such as hedge funds and ‘high frequency’ (or algorithmic) traders, have also emerged to have significant influence.³ As a result of these changes markets are becoming truly global thereby allowing traders to trade almost instantly across a wide variety of products and in markets around the world.

Such innovations have been driven by the benefits global markets provide investors and enterprises. Investors now have access to a diverse array of investment opportunities and at the same time enterprises can issue a variety of securities in different markets which may have the effect of lowering their cost of capital to expand.

However, there can be negative ramifications on markets as they

³ Further details on these changes are set out in Chapter 3.
become more international and interconnected. For example, the Global Financial Crisis in 2008 clearly demonstrated that problems in markets cannot now be easily quarantined and as such troubles in one market can now rapidly spread to other markets around the world.

The aim of this book is to explore another issue which may have emerged in the wake of these dramatic changes to the markets. This is how have these changes impacted upon insider trading and market manipulation which crosses borders? Securities regulators protect the integrity or fairness of the markets through laws and regulations. Important, such laws prohibit unfair trading practices such as insider trading and market manipulation. When such unfair trading practices are detected, securities regulators investigate and can take enforcement action against those that violate these laws and thereby hopefully deter others from engaging in such practices.

Given the changes to the markets and the increased capacity to trade across borders, the question becomes whether this has given rise to new forms of insider trading and market manipulation? Furthermore, are there now greater opportunities to engage in insider trading and market manipulation spanning jurisdictions in order to avoid detection and/or prosecution? If these questions are answered in the affirmative, how have regulators responded? Is that response sufficient? Has the integrity of the markets been preserved?

In exploring these issues a number of other questions arise. First, and perhaps most fundamentally, why is preserving market integrity by taking action against insider trading and market manipulation so important? Secondly, what are these changes to the markets and have these changes altered the types of insider trading and market manipulation which could threaten the integrity of the markets? In other words, have new and different forms of market manipulation and insider trading conduct appeared in the wake of these changes and do such violations now more frequently straddle jurisdictional boundaries? Thirdly, if such changes have occurred, how are securities regulators responding to them and to the new threats they pose? Do they have the capacity in terms of detection, investigation and enforcement tools to robustly tackle securities offences which extend beyond their jurisdiction? Can the effectiveness of such regulators be improved? Is a global approach to these issues required and, if so, how will such an approach be implemented? While this book cannot hope to definitively answer all of these questions, its aim is to explore these concerns and start to develop a picture of what is happening in relation to these issues.
1.1 MARKET INTEGRITY

A focus of this book is the need to ensure the integrity or fairness of the markets. This is because if it is in fact true that the changes to the markets have increased the threat of insider trading and market manipulation, these forms of misconduct would present a challenge to capital markets if not effectively addressed. This is due to the fact that any increase in these unfair trading practices may, over time, cause a reduction in market integrity and thereby decrease investor confidence with the effect that the flow of capital into those markets will be reduced.4 As such, any assault upon market integrity has a direct impact upon investors and listed entities.

However, it is important to note that the impact of threats to market integrity is not limited to investors and listed entities. Securities markets are vital mechanisms by which companies can access finance to grow and develop and are therefore absolutely critical to the economic and social development of a country or even a region. As such there is a strong public interest in maintaining the integrity or fairness of securities markets. Because of this most regulators of securities markets around the world have as one of their core objectives a requirement to work towards the protection of market integrity or market fairness. This, together with protecting investors, improving the efficiency of markets and protecting the markets from systemic risk, now form the four fundamental goals of securities regulation.5

1.2 MARKET ABUSE AND MARKET INTEGRITY

One of the main ways in which securities regulators seek to comply with their core function of protecting the integrity or fairness of the markets is to eliminate, or at least suppress, market abuse. Market abuse refers to actions which unfairly take advantage of other participants in the market or actions which give a false appearance of the price or trading of securities. It consists, first, of insider trading, also known as insider dealing. In brief, insider trading can be defined to encompass the actions of a person

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4 Previous instances of disclosed market abuse have impacted upon markets, reducing market valuations and shaking investor confidence. For example, there was manipulation and insider trading associated with the collapse of Enron in 2001, see generally P.M. Healy and K.G. Palepu, ‘The Fall of Enron’ (2003) 17(2) Journal of Economic Perspectives 3 and W.W. Bratton, ‘Enron and the Dark Side of Shareholder Value’ (2002) 76 Tulane Law Review 1275.

5 The concept of market integrity is explored more fully in Chapter 2.
or entity in taking advantage of their access to non-public information by either trading on the basis of that information, or passing it on to others who in turn trade on that information. Market abuse also encompasses various acts designed to mislead or manipulate the market with the effect that the market no longer properly reflects the genuine forces of supply and demand. Collectively, acts intended to mislead or manipulate the market are known as market manipulation. Market manipulation occurs when a person engages in misconduct which leads to false impressions about the price of securities which could lead to distorted valuations or artificially inflated or deflated prices.

Although market abuse incorporates both insider trading and market manipulation, it is not a term of art and could also be more broadly defined to include a wide range of dishonest or fraudulent practices which may in some way have a negative impact upon investors. However, this book is confined to insider trading and market manipulation because these are the actions which impact directly upon the integrity of the markets.

In their role of protecting markets from market abuse, securities regulators are charged with the responsibility of taking enforcement action against such abuse. Although there is debate about how rigorous and punitive such enforcement has to be to achieve compliance, there appears

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6 The breadth of use of inside information which may be prohibited differs between jurisdictions. See generally E. Avgouleas, The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis (Oxford University Press, 2005).

7 Ibid. 4 and P. Barnes, Stock Market Efficiency, Insider Dealing and Market Abuse (Ashgate Publishing Group, 2009) 9.

8 Avgouleas (n. 6) 4.

9 This is also consistent with the definition of market abuse as set out in first European Union Directive on Market Abuse, see Council Directive 2003/6/EC on insider dealing and market manipulation (market abuse) [2003] OJ L86/16. This Directive states (at recital (12)): ‘Market abuse consists of insider dealing and market manipulation. The objective of legislation against insider dealing is the same as that of legislation against market manipulation: to ensure the integrity of Community financial markets and to enhance investor confidence in those markets’. Other types of dishonest behaviour involving securities are not included in this book as they do not directly mislead or affect the market for securities. For example, one dishonest practice associated with securities, but not considered here, is the practice known as ‘churning’. This consists of excessive trading in a client’s account by a broker wishing to maximize commissions regardless of the client’s best interests. While this type of activity is dishonest and impacts upon the broker’s client, this practice does not directly impact upon the integrity of the market. Similarly, the dishonest activity when persons are contacted, usually ‘cold called’, and sold securities not listed on any exchange is not included within the definition of market abuse in this book. However, where persons are sold securities on an exchange and the price is manipulated this is included.
to be a growing consensus, based upon empirical evidence, that at least some level of enforcement is necessary. As such, the G20 group of countries has identified the effective enforcement of rules surrounding the financial markets as an important aspect of strengthening global financial stability.

1.3 CROSS-BORDER MARKET ABUSE

This book seeks to explore the question of whether the changes to the markets that have taken place over the last two decades have created new avenues to engage in market abuse that straddles international boundaries, as well as the challenges in detecting, investigating and prosecuting such market abuse.

Insider trading and market manipulation that crosses such international boundaries will often be referred to in this book as ‘cross-border market abuse’. This comprises instances of market abuse where all of the acts, events or activity that constitute the market abuse spans two or more jurisdictions. This could involve, for example, a person with material insider information in one jurisdiction placing an order on an exchange in another jurisdiction. It could also involve improperly exploiting markets located in different jurisdictions; for example, manipulating cross listed securities by placing orders for the same security across different markets.

1.4 NATIONAL SECURITIES REGULATORS BUT INTERNATIONAL MARKETS

Despite the internationalization and interconnectedness of the markets for securities, the regulation of securities markets is still undertaken at the national level and the detection, investigation and prosecution of serious market abuse offences remains the responsibility of national securities regulators, sometimes with the assistance of self-regulatory

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10 For further details see discussion in Chapter 2.
organizations. This status quo is likely to continue because the establishment of a global body to regulate and supervise the markets would require nations to surrender sovereignty over regulatory and/or enforcement powers to some form of supranational body. It is highly improbable that countries would agree to such change in the foreseeable future because of political and constitutional constraints.

Supervision of the markets of individual countries by their respective national regulators gives rise to potential difficulties if those regulators detect an increasing frequency of cross-border market abuse in circumstances where their detection, investigation and enforcement powers are limited to their home jurisdiction. In some instances there may not be a sufficient jurisdictional connection to allow the regulator to take action. In other cases, the regulator may not be able to obtain the required evidence and testimony to complete the investigation from outside of the jurisdiction. Furthermore, cross-border market abuse will almost inevitably be more difficult for a country’s securities regulator to detect than market abuse that takes place solely within the confines of its own jurisdiction. This is because limits in the reach of regulator’s powers may result in the investigation not making the necessary connections between, for example, an insider, on the one hand, and the person who eventually trades on the basis of non-public price sensitive information, on the other.

Some of these difficulties might be able to be addressed by enacting legislation to extend the extra-territorial reach of the securities regulator’s jurisdiction and powers. But this, by itself, is unlikely to be sufficient. The involvement and cooperation of government agencies in other countries is almost certainly going to be required in order to effectively tackle many cases of cross-border market abuse. In addition, despite the fact that countries are unlikely to surrender powers to a supranational body, an international organization, such as the International Organization of Securities Commissions (IOSCO) may be able to play a decisive role in coordinating the international enforcement activities of securities regulators.

13 In Canada, securities are regulated at the provincial or territorial level, although many market regulatory functions are delegated to a national self-regulatory body, the Investment Industry Regulatory Organization of Canada (IIROC). Canada is moving towards a more national system of regulation as some provinces move to adopt a uniform Securities Act, to be called the Capital Markets Act, governed by one regulator, to be called the Capital Markets Regulatory Authority. See generally ‘The Cooperative Capital Markets Regulatory System’, http://ccmr-ocrmc.ca/ (accessed 7 February 2017).

14 See e.g., R v. Libman [1985] 2 SCR 178, which delineates the limits of the jurisdiction of Canadian courts in relation to criminal offences where part of the activity took place outside of Canada.
Introduction

1.5 RESEARCHING MARKET MANIPULATION AND INSIDER TRADING ACROSS BORDERS

This book will examine how the markets have become more sophisticated and consider whether, because of these changes, there has been a transformation in the types and instances of market abuse and, in particular, market manipulation and insider trading which crosses borders. In addition, this book also seeks to analyse whether or not regulators’ enforcement efforts are keeping pace with these changes.

In relation to the transformation of the markets and the regulatory response to such changes, documentary and archival research was undertaken to identify the main developments that have occurred to securities markets over the last two decades. Similarly, documentary research was undertaken in order to detail the principal changes that have been made in relation to laws, regulations and policy which may impact upon the securities regulators’ ability to stop cross-border market abuse.

Determining what is occurring in relation to cross-border market abuse in the face of the changes to the markets presented the most challenging aspect of this research. Obviously no one who has successfully engaged in market abuse without detection is likely to disclose this to anyone, including those conducting research in this area. As such, currently information in relation to what is occurring in relation to cross-border market abuse can only be gleaned from two sources: first, instances of cross-border market abuse that have been detected and reported by securities regulators; and secondly, unusual activity that is detected in markets which is not explained by the ordinary forces of supply and demand. Both methods have their limitations.

Attaching significance to the number of matters detected by securities regulators is problematic simply because the cases detected may not be a true reflection of the actual extent of market abuse. One concern is that current detection methods may not be sophisticated enough to detect all such abuse. In addition, for those conducting research into this area, information on matters detected may not be available for analysis due to privacy concerns by regulators and also because those authorities typically do not report on cases detected but ultimately not pursued. Information on the number of reported cases may also be misleading as such cases may just only reflect cases that are selected for investigation rather than all those that are detected. Case selection may be affected by considerations such as the priorities of the regulator, the likelihood of success and/or the investigative and prosecutorial resources available. Furthermore, it could be hypothesized that a regulator’s response could also be manipulated if, for example, there is a temptation for it to artificially inflate the problem in
an attempt to increase its resources and power. Alternatively, a regulator may decide to downplay the problem in order to avoid criticism that it is not effectively addressing the issue.

The second source of information on cross-border market abuse, that is, unusual activity detected in markets, also has a number of shortcomings. These include the fact that the detected unusual activity may not in fact be an indication of illegal activity. For example, unusual price increases before a takeover announcement may indicate insider trading but might equally indicate that market participants have merely accurately identified the company in question as a potential takeover target. Data pointing to unusual activity in the market may also not indicate the source of the market abuse or whether it is limited to one jurisdiction.

Despite its limitations, the focus of this book is market abuse reported by regulators. However, some reference is made to current research in relation to measured unusual activity. Mindful of the limitations of drawing conclusions from this first source of information, the research conducted seeks only to ascertain if regulators are detecting more cross-border market abuse, not if there is an increase in the overall level of cross-border market abuse. In addition to ascertaining whether regulators are detecting more cross-border market abuse, the research for this book attempts to identify what barriers may still frustrate the detection of cross-border market abuse.

In considering the information reported by regulators, this book draws upon a combination of methodologies. In this way it is hoped that a more accurate picture of what is occurring in relation to cross-border market abuse and its detection and prosecution has emerged. Different legislative frameworks were examined and interviews were conducted with enforcement staff from securities regulators in each of five jurisdictions, namely Canada, United Kingdom, United States, Australia and Germany. These countries represent just over half of the world’s securities markets.\(^\text{15}\) The principal securities regulators interviewed in these countries are the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany, the Financial Conduct Authority (FCA) in the United Kingdom, the

\(^{15}\) All of these jurisdictions are in the top 12 in the world in terms of market capitalization. Market capitalization of listed domestic companies, World Bank, ‘World Development Indicators: Stock Markets’, http://wdi.worldbank.org/table/5.4 (accessed 7 February 2017). Specifically, in 2015 the United States made up 40.6 percent of the world markets in terms of market capitalization, the United Kingdom 3 percent, Canada 2.6 percent, Germany 2.8 percent, and Australia 2 percent (the UK figure reflects 2010 estimations).
Australian Securities and Investments Commission (ASIC) in Australia, and the Securities and Exchange Commission (SEC) in the United States. In Canada, securities regulation is undertaken by provincial securities regulators. However, the largest of these is the Ontario Securities Commission (OSC) and, as such, staff from this regulator were interviewed. In addition, because of the importance of self-regulatory organizations in Canada and the United States, staff from the two primary self-regulatory bodies in these jurisdictions were also interviewed. These organizations are the Investment Industry Regulatory Organization of Canada (IIROC) and the Financial Industry Regulatory Authority (FINRA). The results of these interviews were subjected to a comparative analysis with a view to identifying common themes.

To reinforce this analysis, documentary and archival material published by the securities regulators from Canada, United Kingdom, United States, Australia and Germany was reviewed. The material analysed in relation to these securities regulators consisted of annual reports for the 10 years from 2006 to 2015, together with (where available) individual case reports on enforcement action taken in relation to cross-border market abuse. In Canada, the reports reviewed were from the OSC, the British Columbia Securities Commission (BCSC) and the umbrella group for Canadian provincial securities regulators, namely the Canadian Securities Administrators (CSA). In addition to collating and analysing this information, the material was also subjected to a comparative analysis with a view to identifying common themes.

Finally, an examination was undertaken of the main international organization involved in assisting securities regulators coordinate their activities to take action against cross-border market abuse, namely IOSCO. IOSCO has developed a framework for securities regulation and is also involved in developing policy which can be adopted by securities regulators to address emerging issues in securities regulation. In addition, IOSCO has developed a Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU) which is proving to be a key tool that can be utilized by securities regulators to exchange the information required for their enforcement activities. Documentary and archival research was undertaken on this organization and the MMoU and supplemented by an interview with staff from the IOSCO General Secretariat.

16 See Chapter 4 as to the exact material that was examined from the Canadian securities regulators.
1.6 STRUCTURE AND ORGANIZATION OF CHAPTERS

This book is divided into the following chapters:

Chapter 2

This chapter outlines some of the important literature pertaining to the investigation and prosecution of insider trading and market manipulation. As such, this chapter explores what is meant by market integrity or market fairness; why they were adopted as key goals of securities regulation; the importance of these concepts to capital markets; and how the elimination of market abuse is linked to these goals. In addition, as this book is premised upon the basis that securities regulators ought to take enforcement action against market abuse, this chapter examines the importance of public enforcement by securities regulators to the enhancement of market integrity.

Chapter 3

This chapter surveys the changes to securities markets that have taken place over the last two decades. It considers why these changes occurred and how these changes may have impacted upon market abuse and its frequency. It also considers the challenges these changes may have caused for securities regulators in terms of the detection, investigation and prosecution of market abuse and cross-border market abuse. Finally, this chapter examines the regulatory responses of certain governments to the changes and how these new laws may deter market abuse, as well as assist regulators in their efforts to detect, investigate and prosecute market abuse.

Chapter 4

This chapter analyses contemporary developments in relation to market manipulation and insider trading from publicly available material published by the principal securities regulators of Canada, United Kingdom, United States, Australia and Germany, as well as interviews conducted with senior personnel involved in the conduct of investigations. The impact of changes to the markets on the detection, investigation and enforcement of cross-border market abuse is considered further, along with the challenges faced by securities regulators in terms of their investigative methods. This chapter also analyses how regulators have responded to these challenges and suggests some strategies which might possibly be
adopted to improve the detection, investigation and prosecution of cross-border market abuse.

Chapter 5

The cases of cross-border insider trading and market manipulation that have been pursued by securities regulators over the last 10 years fall within a number of broad categories. This chapter details some of the leading cases pursued by securities regulators in relation to each of these categories. In doing so, this reveals some of the highly innovative ways in which securities regulators are detecting and investigating cross-border market abuse. It also demonstrates some of the significant challenges which securities regulators face going forward in their struggle to keep the markets free of market abuse.

Chapter 6

Because of the key role that IOSCO now plays in the investigation and enforcement of cross-border market abuse, this chapter examines IOSCO in depth. It sets out how IOSCO evolved to a position of prominence as a global network of securities regulators and how the IOSCO MMoU was formulated. The terms and conditions of the MMoU are considered together with how the MMoU is being utilized by securities regulators during their investigations. This chapter also considers how the MMoU is being utilized by IOSCO in its efforts to move towards global convergence of securities regulation.

Chapter 7

Given the success of IOSCO, particularly with respect to the MMoU, this chapter considers how IOSCO might build upon that success, as well as possible challenges that may arise with respect to the MMoU moving forward. This chapter also considers the recently announced IOSCO Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (EMMoU).

In addition, this chapter suggests other ways in which IOSCO might further assist in coordinating the activities of securities regulators in terms of tackling cross-border market abuse by way of specific policies that could be developed and, in the absence of a supranational global securities regulator, how IOSCO might work to fill this gap. In particular, the chapter considers other roles IOSCO could play beyond the expansion of the MMoU and policy development. Given its success with respect to the
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MMoU, this chapter also suggests other systems and tools which IOSCO could possibly develop which might be used by securities regulators in their efforts to detect, investigate and prosecute market abuse. Finally, this chapter also considers whether such systems, if developed, could be utilized by IOSCO as a lever to work towards the convergence of securities regulation around the world.

Chapter 8

The conclusion reflects upon the findings that flow from the previous chapters. This analysis reveals that the changes in the markets that have occurred do appear to have given rise to new avenues to engage in cross-border market abuse. Securities regulators are steadily detecting more complex instances of cross-border market abuse and have taken some significant steps to improve their detection and investigation techniques. However, more can be done to confront this misconduct. As such, this book concludes by making some recommendations about how this might best be achieved.