DUTY-FREE INSIDER TRADING?

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Until recently, the enforcement of insider trading violations was generally less robust outside the United States because of the limited sanctions, resources, and powers available to regulators abroad. This situation is slowly changing, especially in the United Kingdom, where the Financial Services Authority has begun to police the offense vigorously. However, the approaches to regulating insider trading and market abuse differ fundamentally across the Atlantic.

In the United States, the offense is not statutorily defined. It is based on judicial and administrative interpretations of a broad securities antifraud statute and accompanying U.S. Securities and Exchange Commission rules, which is reminiscent of a common law approach. The offense can be either criminal or civil, and because it is derived from an antifraud statute, it has been interpreted by courts as requiring a showing of intent. In the European Union, the offense of insider dealing was defined in a detailed statutory directive known as the Market Abuse Directive, which has been implemented through legislation by the EU Member States. In addition to defining the offense statutorily, the U.K. and EU regimes differ from the U.S. antifraud framework in that the offense is premised on the concept of parity of information; there is no requirement that there be deceptive or misleading conduct, or breach of a fiduciary duty or similar relationship of trust and confidence. The parity-of-information approach was urged by the Securities and Exchange Commission but explicitly rejected by the U.S. Supreme Court in Chiarella v. United States as too broad in scope, given that Rule 10b-5, the rule allegedly violated, is grounded in fraud. Under the parity-of-information approach, the focus is on the information the person trading has, not how he or she obtained it from his or her source, or whether or not he or she intended to violate the law.

Recent cases in the United Kingdom and in the United States highlight how punishable behavior in one regime may not constitute a violation in the other. Given the inefficiency of overlapping and conflicting regulations, the growing globalization of markets, and the tendency to apply antifraud prohibitions extraterritorially, the strengths and weaknesses of the U.S. and U.K. regimes should be evaluated with an eye to adopting a common approach in an area critical to market integrity. We conclude that the United States should enact a statutory rule of law based on the parity-of-information approach in the European Union, being sensitive, however, to protecting trading activity based on information obtained through legitimate and socially valuable independent research, a goal addressed by the U.K. framework.

I. INTRODUCTION

The strong stance taken by the United States against insider trading—an offense commonly referred to as “insider dealing” in foreign countries—has led these other jurisdictions to ban the offense as well. Until recently, the enforcement of insider trading violations was generally less

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robust outside the United States because of the limited sanctions, resources, and powers available to regulators, and their reluctance to use rigorous criminal enforcement. This situation is slowly changing. As Jamie Syminton, Head of Wholesale Enforcement at the Financial Services Authority (“FSA”), recently explained, in the United Kingdom “a few years ago it would have been near impossible to imagine that . . . people in the general public would have known about or been interested in what insider dealing is, or that there is a body called the FSA that polices it.” However, today “the FSA has become a visible and credible force combating insider dealing. . . . [It is] determined to crack down on market abuse and capable of doing so.” In 2012 alone, the FSA issued a total of eleven decisions involving civil market abuse violations and secured ten criminal convictions, including the highest ever jail term of four years. The United States also increased the number of insider trading enforcement actions in 2012, with highly publicized criminal convictions making headline news, including those of Raj Rajaratnam, the founder of Galleon Group, and Rajat Gupta, the former director of Goldman Sachs.

However, the approaches to regulating insider trading and market abuse differ fundamentally across the Atlantic. In the United States, the offense is not statutorily defined. It is based on judicial and administrative interpretations of a broad securities antifraud statute and accompanying Securities and Exchange Commission (“SEC”) rules, which is reminiscent of a common law approach. The offense can be either criminal or civil, and because it is derived from an antifraud statute, has been interpreted by courts as requiring a showing of intent. In the European Union, the offense of insider dealing was defined in a detailed directive known as the Market Abuse Directive (“MAD”), which has been implemented by the EU member states. Because MAD was a minimum directive, the United Kingdom treated it as a floor and implemented a stricter, so called “gold-plated” regime, which includes both criminal and civil penalties. In addition to defining the offense statutorily, the U.K. and EU regimes differ from the U.S. antifraud framework in that the offense is premised on the concept of parity of information; there is no requirement that there be deceptive or misleading conduct. The parity-of-information approach was urged by the SEC but explicitly rejected by the U.S. Supreme Court in Chiarella v. United States as too broad in scope, given that Rule 10b-5, the rule allegedly violated, is grounded in fraud. Under the parity-of-information approach, the focus is on the information possessed by the person doing the trading, not how he or she obtained it from his or

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2 Id.


6 Id.


9 Chiarella, 445 U.S. at 234.
As a result of these differences, the same conduct might violate one but not the other regime. This difference raises interesting questions in the context of securities that are listed and traded in multiple jurisdictions.

Recent cases such as Einhorn and Hannam in the United Kingdom, and cases such as Cuban, Dirks, Wyly, and Steffes in the United States highlight how punishable behavior in one regime may not constitute a violation in the other. Given the inefficiency of overlapping and conflicting regulations, the growing globalization of markets, and the tendency to apply antifraud prohibitions extraterritorially, the strengths and weaknesses of the U.S. and U.K. regimes should be evaluated with an eye to adopting a common approach. We conclude that the United States should enact a statutory rule of law based on the parity-of-information approach in the European Union, being sensitive, however, to immunizing trading activity based on information obtained through legitimate and socially valuable independent research.

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13 SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

