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A New Playbook: Part 2 – Global Securities Enforcement Activity Stepping Up to Meet New Market Challenges

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- For a comprehensive analysis of 10b-5 securities fraud class actions from 2010-2012, please see Weil's *The 10b-5 Guide*.

About a year ago, we published "A New Playbook for Global Securities Litigation and Regulation," in which we detailed dramatic changes in the global securities regulatory and litigation arena driven by various factors, including not only the financial crisis of 2007-2008, but also changes in tolerance in the United States to litigation brought by foreign investors against public companies listed on non-US exchanges.

One year later, the regulatory environment continues to revamp with new rules being issued constantly in the United States to conform to the legislative mandates set forth in the Dodd-Frank Act. The United Kingdom and European Union also seek to reinforce previous global initiatives to reform and strengthen the Pan-European financial markets.

What is more ever-present, however, is the marked increase in global enforcement activities by regulators in the United Kingdom, Canada, and the European Union, which are attempts to give teeth to the global financial reforms each jurisdiction felt necessary to potentially prevent a "repeat" of the financial crisis. This article seeks to address the increase in global securities enforcement activity, and concludes that continued cooperation and coordination in enforcement activities will be required to seamlessly address the desire to strengthen global regulatory initiatives aimed at harmonizing and centralizing international securities regulation to create safer, more fundamentally sound financial markets for investors.

Global Enforcement Efforts outside the United States

The United Kingdom

Perhaps the most dramatic change in any country's regulatory and enforcement scheme over the past twelve months is the United Kingdom's decision to replace the Financial Services Authority (FSA) as the single financial services regulator with two successor bodies: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). This "split" becomes effective on April 1, 2013 and comes from the Financial Services Bill of 2012, which received royal assent on December 19, 2012.[2]

While the PRA will focus on the day-to-day supervision of large banking institutions, insurers, and certain investment firms with significant risk on their balances sheets, the FCA will focus exclusively on consumer protection, market integrity, and conduct issues: regulating how and what services are provided to consumers, and ensuring such services are delivered to consumers so they can rely on the integrity of the markets. The remit of the two bodies will, however, overlap and many large financial institutions will be dual regulated. In an October 2012 speech, Managing Director of the Conduct Business Unit of the FSA (soon to be FCA) Martin Wheatley noted, "Good wholesale conduct relies on effective policing of market abuse. People carrying out transactions in UK markets need to have confidence that they are operating on a level playing field with everyone else. Our approach to market conduct will reinforce the strong track record the FSA has built, where 20 criminal convictions for insider trading have been secured since 2009."[3]

The FSA had an extraordinarily active year in 2012, particularly with regard to alleged LIBOR manipulation. That activity continues in early 2013 with the February 6, 2013 announcement of a total of $612 million of fines against RBS, including a £87.5 million fine from the FSA related to the bank's role in the LIBOR scandal.[4] According to one recent report, "the 10 largest FSA fines of all time now include five 2012 cases."[5] After RBS, the second and third largest FSA fines, which were assessed against UBS AG and Barclays Bank plc (at £160 million, and £59.5 million, respectively) in 2012, also related to the LIBOR scandal.[6] Going forward, it remains to be seen whether the new FCA will continue to pursue the more "high profile" cases against large banking institutions, or will aim its focus at the rest of the market where fines and penalties assessed have dropped.[7]

Initial indications of the FSA's approach in 2013 are mixed. The FSA's commitment to a strong individual deterrence program is reflected by the fact that six individuals are currently facing prosecution for alleged insider dealing and three more were recently arrested on suspicion of such offences.[8] On the other hand, there remains a robust focus on the activities of major financial institutions, as reflected by the FSA's confirmation that it will undertake a wide-scale review of sales of interest rate hedging products to small businesses.[9]

European Union Enforcement Activities and Initiatives

Enforcement activity in the European Union has taken a different track than in the United Kingdom, primarily because there is no "one" securities enforcement regulatory authority with the power to prosecute financial crimes across Europe. As Professor Eric C. Chaffee observed, the International Organization of Securities Commissions (IOSCO), formed in 1983, "is unable to achieve the harmonization and centralization necessary to regulate the emerging global capital markets. The organization mainly serves a monitoring function, rather than providing a centralized force for regulation and enforcement."[10] That enforcement authority is generally limited to the particular countries that have signed on as members of the IOSCO through Multilateral Memorandums of Understanding.[11] However, many of these members do not have the wherewithal or ability to create an enforcement mechanism within their geographical boundaries. Nevertheless, IOSCO members (like the United States) regulate 95 percent of the world's securities markets.[12]

Following the financial crisis, the European Securities and Markets Authority (ESMA) was established in 2010 to continue the work carried out by a previous European regulatory body. The ESMA was given the power and authority to strengthen coordination among European supervisors and to enable ESMA to take action to ensure the consistent application of rules and facilitate coordinated decision-making. Those responsibilities are organized by ESMA through European Enforcers Coordination Sessions (EECS), a forum containing 37 European enforcers from 29 countries, which coordinates enforcement activities that are, in sum, delegated to enforcement authorities within the member states.[13] The EECS monitors and reviews financial statements published by issuers on regulated European securities markets in accordance with International Financial Reporting Standards (IFRS), and considers whether those financial

statements comply with IFRS and other reporting requirements, including any relevant national laws of the home country of the issuer.[14] The IFRS are developed by the International Accounting Standards Board (IASB), with interpretative guidance provided by the IFRS Interpretations Committee.[15]

Since 2011, ESMA, by and through the EECS, has been actively publicizing areas the EECS will focus on when reviewing the financial statements of European-listed entities. In 2011, not unexpectedly, the EECS was focused on publicly traded companies in the financial institution sector and how those companies portrayed their exposure to sovereign debt. The EECS issued two public statements in July and November 2011 that stressed both the need for transparency in reporting exposures consistent with the relevant IFRS and on a country-by-country basis.[16] In 2011, the EECS commenced 18 enforcement actions that required the issuance of revised financial statements, around 150 actions that required public corrective notes or other public announcements, and approximately 420 actions that required corrections in future financial statements.[17]

In November 2012, ESMA issued further guidance regarding EECS's areas of concentration. In addition to continued focus on disclosures related to sovereign debt exposures and the impairment of financial instruments tied to or related to the sovereign debt crisis, ESMA will also focus on the impairment of non-financial assets, the measurement of discount rates used to measure post-employment benefit obligations, and disclosures related to contingent assets and contingent liabilities.[18]

Significantly, however, there is "a general impetus in the EU ... to move to a much more robust and ambitious market abuse regulatory framework."[19] The general desire to institute an effective regulatory mechanism is embodied by the proposed Market Abuse Regulation (MAR) and updated Market Abuse Directive (MAD II), and both regulations are likely to become effective by the end of the year.[20]

Importantly, the proposals seek to address a concern that there are, at present, safe havens within the European Union for those who trade on inside information or engage in market abuse. Most notably, Austria, Bulgaria, Slovakia, the Czech Republic, Estonia, Finland, and Slovenia do not criminalize insider trading and/or market abuse.[21] While the impact of the reform is likely to be minimal in jurisdictions such as the United Kingdom, which already have robust regulatory frameworks, jurisdictions with less stringent legislation for deterring financial crime are likely to see significant improvements in the tools available to them to tackle insider trading and market abuse.

The enhanced regulatory framework has also been responsive to recent benchmark manipulation with respect to LIBOR and EURIBOR. The proposed reforms have, accordingly, been updated to impose civil sanctions for actual or attempted manipulation of benchmarks amounting to market manipulation. Benchmark manipulation will also constitute a criminal offense under the proposals' expanded scope, which will impose sanctions on both those who carry out the manipulation or aid and abet those who do, as well as individuals engaging in its incitement.

Canadian Enforcement Activities

In our last "Playbook" article, we mentioned that Canada was considering consolidating its 13 provincial securities regulators into one single regulatory enforcement agency at the federal level. While that initiative was later rejected by the Supreme Court of Canada, securities enforcement activity remains strong, though it is down in relative terms from past years. According to the 2011 report of the Canadian Securities Administrators (which comprises the ten Canadian provinces and the three territories), 126 proceedings were commenced in 2011, down from 178 in 2010.[22] $52 million in fines were assessed during 2011 - $41 million of which were in connection with illegal distributions.[23]

The drop in securities enforcement activity appears to coincide with the decrease in securities class actions filed in Canada. According to NERA, in 2012 only nine new securities class actions were filed in Canada, down from 15 in 2011.[24] NERA notes that the decrease in securities class actions corresponds with a drop in both Chinese reverse merger class actions

and credit crisis class actions, which were large drivers of class actions filings since 2008.[25]

Enforcement Efforts — The United States Looking Outwards

So where does the United States factor into this global enforcement picture? From an "outward" reach perspective, the SEC undoubtedly continues to monitor SEC-regulated firms with headquarters overseas. Foreign firms registered with the SEC must generally comply with US securities laws and rules, including requirements that the registrant maintain certain books and records, and submit to examinations conducted by SEC staff.[26] The SEC also has supervisory memorandums of understanding with various overseas counterparts (like the UK FSA and the Ontario Securities Commission[27]) that allow the SEC and its foreign counterparts equal access to information that will permit supervisory oversight over large global financial institutions, broker-dealers, and investment advisers.[28]

Further, Section 929P(b) of the Dodd-Frank Act extends the jurisdictional reach of the anti-fraud provisions of US securities laws to securities transactions occurring outside the United States that involve only foreign investors, as well as conduct occurring outside the United States that has a foreseeable effect within the United States. It is important to note that this section of the Dodd-Frank Act is limited to actions brought by the SEC (and not private civil actions).[29]

The United States also has a "seat at the table" on the boards of many of the organizations mentioned above, including IOSCO, the Financial Stability Board[30] and the IFRS Foundation Monitoring Board, the overseer of the IASB. The SEC also participates in the Council of Securities Regulators of the Americas (an organization composed of securities regulators in the Western Hemisphere) and the Organization for Economic Cooperation and Development.[31] As noted above, however, the United States does not currently subscribe to the use of IFRS. Instead, it continues to follow generally accepted accounting principles established by the Financial Accounting Standards Board. Though this topic has been explored for years, the United States does not seem to be close to adopting the IFRS.[32]

Conclusion – So Where Does This All Lead?

Precipitated by the global credit crisis, and in large part by the international reach of Dodd-Frank, never before have the global financial markets been subject to such increased regulation as they face today. In large part, the benefits of such regulation have been mixed. Here in the United States, regulation of large financial institutions has dramatically increased, and will continue to do so as more and more of the mandates set forth by Dodd-Frank (like the Volcker Rule) become law (or the subject of continued rule-making by the SEC).

In the United Kingdom, given the strong activity of the FSA in 2012, we think the FCA should be off to a running start, though the question remains where the emphasis of its enforcement activities will lie. Will it be weighted towards "headline" events such as continued enforcement of the UK Bribery Act and continued LIBOR investigations and prosecutions? Or will the FCA focus its efforts more on day-to-day "blocking and tackling" regulatory issues in its dealing with large global financial institutions, hedge funds, and private equity funds?

As for the European Union, the challenge remains in translating the necessity to oversee and regulate large global firms with the sheer fact that such regulatory authority needs to be ultimately delegated to each individual member state of the European Union, each of which might have their own views as to how to regulate firms within their borders (or not to regulate due to budgetary constraints that might not allow them to proceed). The forthcoming implementation of the MAR and MAD II may, however, go some way to instituting much needed uniformity in addressing financial misconduct across the European Union.

Despite the enormous progress that many jurisdictions have made to give teeth to necessary regulatory changes, enormous challenges remain. As noted by Professor Chafee in his article, given the SEC's enormous head start in the regulatory

process and despite the United States failure to adopt IFLRS, the SEC is probably in the best position to push towards harmonization and centralization of international securities laws in an effort to prevent a potential repeat of the 2008 financial crisis.[33]

1 The authors would like to thank Amanda L. Burns for her substantial contributions to this article. Mr. Carangelo and Mr. Ferrillo are also co-authors of *The 10b-5 Guide*, an authoritative primer on securities fraud case law for both business professionals and legal practitioners.

2 *See* Press Release, HM Treasury, Financial Services Bill Receives Royal Assent (Dec. 19, 2012), http://www.hm-treasury.gov.uk/press_126_12.htm.

3 Martin Wheatley, Managing Director, Conduct Business Unit, FSA, Speech at BBA Annual Banking Conference, London: The FCA: The Future of Conduct Regulation (Oct. 17, 2012), *available at* http://www.fsa.gov.uk/library/communication/speeches/2012/1017-mw.shtml.

4 *See RBS and Libor: The Wrong Stuff*, THE ECONOMIST, Feb. 9, 2013, *available at* http://www.economist.com/news/finance-and-economics/21571446-widening-scandal-threatens-suck-more-banks-and-ruin-more-careers-wrong.

5 NERA ECONOMIC CONSULTING, FSA CALENDAR UPDATE 2012, 2 (2013), *available at* http://www.nera.com/nera-files/PUB_FSA_Trends_A4_0113.pdf.

6 *Id*. at 3. These fines were part of cross-border investigations in cooperation with US authorities, which also levied fines. *Id*.

7 *Id*. at 4 ("Setting aside these largest fines, the size of more typical fines, measured by the median, has dropped to the 2010/11 level of £600,000."); *id*. at 5 ("This year has witnessed a sharp decline in the number and aggregate amount of fines against individuals.").

8 *See* Press Release, FSA, Three Arrested in FSA Insider Dealing Investigation (Feb. 27, 2013), http://www.fsa.gov.uk/library/communication/pr/2013/018.shtml.

9 *See* Press Release, FSA, FSA Confirms Stat of Full Review of Interest Rate Swap Mis-selling, (Jan. 31, 2013), http://www.fsa.gov.uk/library/communication/pr/2013/010.shtml.

10 Eric C. Cahhee, *The Internationalization of Securities Reform: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187, 200 (2010), *available at* http://heinonline.org/HOL/Page?handle=hein.journals/jobtela5&div=18&g_sent=1&collection=journals.

11 *See* Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, International Organization of Securities Commissions (2012), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf.

12 For a list of current IOSCO Memorandum of Understanding Signatories, see http://www.iosco.org/library/index.cfm?section=mou_siglist.

13 *See* EUROPEAN SECURITIES AND MARKETS AUTHORITY, 12TH EXTRACT FROM EECS'S DATABASE OF ENFORCEMENT 3 (2012), *available at* http://www.esma.europa.eu/system/files/2012-656.pdf (hereinafter, the "2012 Report").

14 *Id*.

15 The parallel organization in the United States for accounting standards is the Financial Accounting Standards Board. The United States is the only country in the world that does not follow the IFRS or the IASB. *See* REBECCA CELLUCCI, THE INTERNATIONAL ACCOUNTING STANDARDS BOARD 17 (2012), http://neumann.edu/academics/divisions/business/journal/Review2011/Cellucci.pdf.

16 *See* EUROPEAN SECURITIES AND MARKETS AUTHORITY, ACTIVITY REPORT ON IFRS ENFORCEMENT IN THE EUROPEAN ECONOMIC AREA IN 2011 11 (2012), *available at* http://www.esma.europa.eu/system/files/2012-412.pdf.

17 *See id*. at 15.

18 *See* Public Statement, European Securities and Markets Authority, European Common Enforcement Priorities for 2012 Financial Statements (Nov. 12, 2012), *available at* http://www.esma.europa.eu/system/files/2012-725.pdf.

19 *See* David Lawton, FSA Director of Markets, Speech at the Practising Law Institute Conference: Four building blocks of efficient capital markets, (Feb 1, 2013), *available at* http://www.fsa.gov.uk/library/communication/speeches/2013/0201-dl.

20 Press Release, European Commission, Getting Tough on Insider Dealing and Market Manipulation (Oct. 20, 2011), *available at* http://europa.eu/rapid/press-release_IP-11-1217_en.htm?locale=en.

21 Jeremy Woolfe, *Prison Sentences for all EU Market Abusers on the Way*, FIN. TIMES, Oct. 28, 2012, http://www.ft.com/intl/cms/s/0/a80f62ac-1d24-11e2-abeb-00144feabdc0.html.

22 *See* CANADIAN SEC. ADM'RS, 2011 ENFORCEMENT REPORT 7 (2012), *available at* http://er-ral.csa-acvm.ca/wp-content/uploads/2012/02/CSA_2011_English.pdf (hereinafter, "the 2011 Report").

23 *Id*. at 9.

24 NERA ECONOMIC CONSULTING, TRENDS IN CANADIAN SECURITIES CLASS ACTIONS: 2012 UPDATE 1 (2013), *available at* http://www.nera.com/nera-files/PUB_Recent_Trends_Canada_0213.pdf.

25 *Id*.

26 *See* Elisse Walter, SEC Commissioner, Speech at the International Institute on the Inspection and Oversight of Market Intermediaries: Supervisory Cooperation: The Next Frontier for International Securities Regulation (July 6, 2010), *available at* http://www.sec.gov/news/speech/2010/spch070610ebw.htm.

27 *See, e.g.*, Memorandum of Understanding, Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms, US SEC-UK FSA, Mar. 4, 2006, *available at* http://www.sec.gov/about/offices/oia/oia_multilateral/ukfsa_mou.pdf.

28 *Id*. The US is also signatory to an IOSCO Multilateral Memorandum of Understanding which allows regulators in more than 70 jurisdictions to share information needed to support their investigations. *See supra*, note 12.

29 The SEC recently used Section 929J of the Dodd-Frank Act in filing administrative charges against the international affiliates of five large accounting firms in connection with investigations of Chinese reverse merger companies for failing to produce their work papers. *See* Press Release, SEC, SEC Charges China Affiliates of Big Four Accounting Firms with Violating U.S. Securities Laws in Refusing to Produce Documents (Dec. 3, 2012), http://www.sec.gov/news/press/2012/2012-249.htm.

30 The Financial Stability Board was "established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts." Financial Stability Board, Overview, http://www.financialstabilityboard.org/about/overview.htm.

31 *See* Advancing the SEC's Mission through International Organizations, http://www.sec.gov/about/offices/oia/oia_intlorg.shtml.

32 *See* Cahhee, *supra* note 10, at 202.

33 *Id*. at 205-06.

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