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London Update

UK Financial Services Regulatory Developments

April 2007

UK Financial Services Authority ("FSA") Uses Power to Wind up Company for Regulatory Breach

In a decision handed down on February 23rd, the High Court granted a winding-up petition brought by the FSA under section 367 of the Financial Services and Markets Act 2000 ("**FSMA**").

The Inertia Partnership LLP ("**Inertia**") introduced companies that wanted to raise capital to a British Virgin Islands company, which engaged brokers as "boiler rooms". Inertia entered into agreements with two of the companies whereby it issued application forms, was named as the receiving agent, collected money for, and distributed it to the companies. The brokers cold-called consumers in the UK and offered them the opportunity to buy shares in the companies. Inertia later went into a creditors' voluntary liquidation.

The Court held that petitions could be brought by a public official and that the Court had a power to make a winding up order in the public interest on the just and equitable ground. The power should be exercised with a view to protecting the public interest and in so doing the Court needed to balance all relevant interests against each other to ascertain the just and equitable result.

The FSA's petition was on the basis that Inertia had carried on a regulated activity in contravention of the general prohibition in section 19 of FSMA, it was insolvent, and it was just and equitable that it be wound up.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/028.shtml

UK Treasury Committee to Hear Evidence on Private Equity Funds

On March 6th, the Treasury Select Committee of the UK House of Commons announced its plans to hold new hearings on Private Equity Funds. The hearings are being undertaken under the theme of "Transparency in Financial Markets and the Structure of UK Plc". On March 20th, the Treasury Committee announced the terms of reference for its inquiry and the Committee has invited evidence to be submitted on: (1) the regulatory environment; (2) taxation; and (3) the economic context of private equity.

The Committee invites written evidence on this inquiry by Wednesday, May 9th, 2007.

http://www.parliament.uk/parliamentary_committees/treasury_committee/tc200307pn36.cfm

FSA Publishes Updated Measure of UK Market Cleanliness

On March 7th, the FSA published OP25: *Updated Measurement of Market Cleanliness* with the results of its work to measure the cleanliness of the UK financial markets. The exercise examined the period of trading from 2004-2005. Although the results show a decrease in the level of possible informed trading ahead of the trading announcements of FTSE 350 companies, the level of suspicious trading in the UK remains high.

There had been possible insider trading ahead of a takeover announcement in almost one in four cases in 2005. The figure, 23.7%, is down on the 2004 figure of 32.4%. This level has not significantly changed since the introduction of FSMA (possible insider trading was estimated at 24% in 2000). There had been a significant decrease in the level of possible insider trading ahead of trading announcements - such as financial results and updates - by companies in the FTSE 350. In only 2% of those cases were announcements preceded by informed price movements in 2004/5, against 11.1% in 2002/3, and 19.6% in 1998-2000.

The FSA analysed the potential for insider trading by looking at abnormal price movements around the time of disclosure of takeover announcements. The study only looked at cash equities, not derivatives or other trading instruments.

http://www.fsa.gov.uk/pubs/occpapers/op25.pdf

FSA Clarifies Approach to Alternative Investment Regulation

In a speech delivered to an industry conference on March 12th, Dan Waters, Head of Retail Policy at the FSA, outlined the FSA's approach to the regulation of hedge funds and private equity funds.

Waters reiterated that the FSA's view remains that properly run alternative investment funds contribute to the overall efficiency and liquidity of global capital markets.

The key risks identified include potential market disruption, loss of confidence, market abuse and operational deficiencies. To address these, the FSA has: implemented periodic surveys to better understand the risks; enhanced the role of its alternative investments monitoring team (created in 2005); and, increased its co-operation with other international regulators such as the U.S. Securities Exchange Commission and the U.S. Federal Reserve.

To reduce the threat of market abuse and the risk of fraud, the FSA is working with the International Organisation of Securities Commissions ("**IOSCO**") to establish good practice for the valuation of complex assets. FSA will continue to use both prevention and enforcement where necessary to ensure that potential market abuse is minimised. This includes monitoring "hot-spots", the creation of a modern transaction analysis system and further industry co-operation.

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0313_dw.shtml

IOSCO Consults on Valuation Principles for Hedge Fund Portfolios

On March 13th, IOSCO issued a paper for consultation, proposing a set of nine principles for best practice when valuing hedge fund portfolios (the "**IOSCO Valuation Principles**").

The essence of the IOSCO Valuation Principles is to seek to ensure that financial instruments within a hedge fund's investment portfolio are appropriately valued and that these values are not distorted to the disadvantage of investors. The IOSCO Valuation Principles aim to mitigate the potential conflicts of interest that may arise between the hedge fund manager and the hedge fund.

It is recommended that the IOSCO Valuation Principles should act as a guide to assist hedge funds' "governing bodies" (i.e. boards of directors or general partners) and the fund managers, to develop and implement appropriate and consistent valuation policies and procedures in the valuation of hedge fund portfolios and to introduce independence in and transparency of the valuation process.

The IOSCO Valuation Principles are designed to apply across jurisdictions and to different hedge funds and service providers.

Comments on IOSCO consultation should be submitted by June 21st, 2007, and a final paper is expected to be published in Autumn 2007.

http://www.iosco.org/library/pubdocs/pdf/IOSCOPD240.pdf

FSA Sets out Suspicious Transaction Scenarios

In the March 14th issue of its regular *Market Watch* newsletter, FSA gave firms some assistance in understanding their market abuse suspicious transaction reporting obligations.

The requirement to report transactions suspected of constituting market abuse to the FSA is one of the major obligations introduced by the EU's Market Abuse Directive in July, 2005. The FSA implemented this requirement by rules to be found at SUP 15.10 of its rule book.

In deciding what transactions to report, the key test is whether there are reasonable grounds for suspecting the transaction involves market abuse. The *Market Watch* examples clarify the FSA's view of when there are reasonable grounds for a regulated firm to suspect market abuse.

http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter19.pdf

Court Orders Disclosure of Information Prepared for FSA Investigation

In dismissing an appeal by Aberdeen Asset Managers and UBS against a decision ordering the disclosure of certain documents, the UK Court of Appeal held in *Real Estate Opportunities Ltd v Aberdeen Asset Managers Jersey Ltd and others* ([2007] EWCA Civ 197) that the confidentiality provisions of FSMA which preclude the FSA from making disclosure to a third party of information obtained by it in the course of investigations did not provide any protection from disclosure by a party subject to an FSA investigation.

The Court of Appeal held that, for the purposes of section 348 FSMA, a person could not be said to "obtain" information from the FSA which it had collected in the course of inquiries if the authority gave him a document containing information he already possessed even if, as far as the authority was concerned, he was not the source.

The Court further held that section 348 did not impose a bar on disclosure by a secondary recipient of information in (a) a situation where confidential information had been supplied to the FSA by an employee from their own files without having had specific authority to do so, and (b) the situation where the FSA supplied information to a recipient which the recipient already had. The Court concluded that a person did not "obtain" information from the FSA for the purpose of section 348 if he had that information before it was given to him by the FSA. That would be so even if that person were not the "source" of that information in the sense of having authorised an individual on its behalf to give the information to the FSA.

http://www.lawreports.co.uk/WLRD/2007/CACIV/mar05.htm

FSA Fines Analyst £52,500 for Selective Disclosure

On March 20th, the FSA announced that it had fined Roberto Casoni, a former equities analyst with a major investment bank, £52,500 for failing to observe proper standards of market conduct while carrying out his role as an approved person – a breach of Principle 3 of the FSA's Statement of Principles for Approved Persons.

On January 9th, 2006, Mr. Casoni began his employer's internal approval process to initiate coverage of an Italian bank ("**BI**"). However, prior to its publication, Mr. Casoni selectively disclosed details of his valuation methodology, final recommendation and the target price for BI. In one case he also told a client the expected date of publication. The research, which contained a buy recommendation with a target price of €39 per share was published when BI shares were trading at €25.70.

Mr. Casoni's employer brought the matter to the FSA's attention. The FSA took the view that, by disclosing the information, Mr. Casoni had failed to observe proper standards of market conduct. He gave the recipients the opportunity to pre-empt the conclusions of the published research ahead of the rest of the market. The fact that they did not do so was not relevant.

In determining the penalty, the FSA took into account the fact that Mr. Casoni did not have any intention of manipulating BI's share price and he did not make any personal financial gain from his conduct. He co-operated fully with the FSA and agreed to settle this matter at an early stage of the FSA proceedings. In the FSA's view, this entitled him to a 30% reduction in the amount of his fine, from £75,000 to £52,500. Mr. Casoni has not previously been the subject of FSA disciplinary action.

http://www.fsa.gov.uk/pubs/final/casoni_20mar07.pdf

CESR Publishes Guidelines on UCITS Eligible Assets

On March 20th, the Committee of European Securities Regulators ("**CESR**") published guidelines on eligible assets under the Undertakings for the Collective Investment of Transferable Securities ("**UCITS**") Directive. The guidelines complement the Level 2 implementing directive published by the European Commission on March 19th, and clarify the instruments that can be held by funds established under the UCITS Directive for sale to retail investors under the UCITS Directive's cross-border passport.

http://www.cesr.eu/index.php?docid=4421

FSA Publishes Policy Statement on EU Markets in Financial Instruments Directive ("MiFID") Perimeter Guidance

On March 23, the FSA published policy statement PS07/5: "Perimeter Guidance relating to MiFID". This policy statement responds to comments received by the FSA on previous draft guidance relating to the scope of MiFID. The Perimeter Guidance sets out what activities and entities are within the scope of FSA regulation.

Issues discussed include the impact of MiFID on credit institutions, the relationship between the existing regime for authorised professional firms and the MiFID provisions, the regulatory status of forward foreign exchange contracts and the relationship between MiFID investment services and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the statutory instrument which sets out which activities are currently subject to FSA regulation).

The final guidance will take effect from November 1st, 2007, the implementation date of MiFID.

http://www.fsa.gov.uk/pubs/policy/ps07_05.pdf

FSA Review of UK Commodities Markets

The FSA published "Growth in Commodity Investment: Risks and Challenges for Commodity Market Participants" on March 26th. This paper examines the recent increases in investment and new products on UK commodity markets.

The FSA is reviewing possible risks that these may pose to maintaining confidence in the UK financial system including: (1) systems and controls on exchanges dealing with the increased volume of trades; (2) risk management; (3) challenges posed by high volume trading and new trading techniques; and, (4) unsuitability of investments for retail investors.

Consequently, the FSA has announced that it will increase its monitoring of UK commodities markets. FSA regulated firms and exchanges are advised to put in place appropriate measures to detect and prevent improper practices.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/039.shtml

Widening the Market for Alternative Investment Vehicles

On March 27th, the FSA published for consultation its proposals for alternative investment vehicles, including funds of hedge funds, which can be marketed to UK retail investors.

The FSA believes that the introduction of retail-oriented Funds of Alternative Investment Funds is now appropriate as retail investors have been able to gain exposure to hedge funds and other alternative products via vehicles such as structured products for some time. The FSA proposes to introduce substantial structural and operational safeguards including requirements to have an independent depositary, independent valuations and timely redemption of investments.

The consultation closes on June 27th, 2007.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/040.shtml

UK Treasury Minister Responds to Criticism of AIM by SEC Commissioner

On March 8th, U.S. Securities and Exchange Commission ("**SEC**") Commissioner Roel Campos criticized the Alternative Investment Market ("**Aim**") of the London Stock Exchange ("**LSE**") for what he believes is the development of a "casino" culture. At the 11th annual SEC Regulation Outside The U.S. Conference, Commissioner Campos said he was worried about the trend where companies choose their listing venue based on the lowest level of oversight available.

In response on March 28th, UK Treasury Minister Ed Balls defended Aim in comments made at another industry conference. Mr. Balls considered that it was disappointing and surprising that AIM has been the subject of recent unwarranted and inaccurate criticism, given the success of the UK's risk-based approach.

The LSE stated that Mr. Campos' views ". . . do a disservice to the quality small companies choosing to join Aim, the institutions choosing to invest in those companies and the high regulatory standards that the LSE promotes".

Aim's success has been largely attributed to the light-touch regulatory framework which has helped it attract companies from around the world, including the U.S. Mr. Balls observed that Aim exists to fill a niche of the market, typically providing capital for small, growing companies that have outgrown the venture capital stage. The failure rate of Aim companies differs little from the main London market. He emphasized that UK regulation was "light touch" not "soft touch".

http://www.hm-treasury.gov.uk/newsroom_and_speeches/speeches/econsecspeeches/speech_est_280307.cfm

FSA Takes Bankruptcy Proceedings Against UK Lawyer

In proceedings commenced by the FSA, the UK High Court ruled in December 2004 that Adrian Sam & Co. ("**ASC**") and John Martin, one of ASC's two partners, were knowingly involved in the UK activities of an illegal overseas investment firm - a "boiler room". They were ordered to pay £360,000 to 63 investors involved in the boiler room scam. A bankruptcy order was granted against Mr. Martin in August 2006.

On March 29th, Adrian Sam, the second partner in ASC, was also made bankrupt by the Court on the FSA's application. The Court found that the involvement of Mr. Martin, Mr. Sam and ASC was an integral part of the illegal boiler room activity.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/044.shtml

For more information, contact:

	Direct Dial	Email
Martin Cornish	+44 (0) 20 7776 7622	martin.cornish@kattenlaw.co.uk
Edward Black	+44 (0) 20 7776 7624	edward.black@kattenlaw.co.uk
Sean Donovan-Smith	+44 (0) 20 7776 7625	sean.donovan-smith@kattenlaw.co.uk

Upcoming Breakfast Seminar:

Date: 17 April 2007
Venue: London Capital Club, London EC4B 7BW

Listing Funds and Fund Managers on the London Stock Exchange, AIM and Euronext

- Current Position
- Proposed London Stock Exchange Rule Changes
- Creating a Secondary Market for Closed End Funds
- Why List Open Ended Funds?
- Creating Value for the Manager
- Why the Investor Demand is Growing
- Why Managers are Using This Structure

For an invitation please contact terri.duggan@kattenlaw.co.uk

Katten

Katten Muchin Rosenman Cornish LLP

www.kattenlaw.co.uk

1-3 Frederick's Place • Old Jewry • London EC2R 8AE
+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

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