



## London Update

### UK Financial Services Regulatory Developments

April 2009

*This edition covers UK and EU developments between 1 March and 2 April 2009*

#### UK Developments

##### **FSA Issues Rules Mandating Disclosure of Contracts for Difference (CfDs)**

On 3 March, the Financial Services Authority (FSA) published a feedback statement and final rules on the disclosure of long positions held as Contracts for Difference (CfDs). This follows from its consultation paper CP08/17 on the disclosure of CfDs published in October 2008, as reported in the November 2008 edition of *London Update*. As foreshadowed by CP08/17, the FSA will implement a general disclosure regime for long CfD positions. The initial disclosure threshold will be at 3%, in line with the existing UK disclosure rules for long positions in equities. Further disclosures are required as each 1% threshold is passed thereafter. Again the same as the long equities disclosure regime.

Under the new CfD rules, position size is to be calculated on a delta-adjusted basis rather than a nominal basis. There is an exemption to the disclosure requirements for CfD writers which act as regulated intermediaries. The FSA has introduced this in order to reduce unnecessary disclosures. Exemptions paralleling those for market makers and trading book in the equity disclosure regime are also implemented. The new rules take effect on 1 June.

[http://www.fsa.gov.uk/pubs/policy/ps09\\_03.pdf](http://www.fsa.gov.uk/pubs/policy/ps09_03.pdf)

##### **FSA Signals Regulatory Sea Change**

In a speech delivered on 12 March, Hector Sants, Chairman of the FSA, signalled a new era of intensive FSA supervision.

Mr. Sants declared that the philosophy of principles-based regulation, generally characterised as “light touch” is to be replaced by a more “intrusive and direct style of supervision”.

The reasons for the change are based on lessons learned from recent market events as well as a change in the regulator's philosophy. Further, “to suggest that we can operate on principles alone is illusory, particularly because the policy-making framework does not allow it. Europe, in particular, has a particular penchant for rules and in any case in a number of key areas such as prudential they are indeed necessary”.

Mr. Sants characterised the future direction of the FSA as “outcomes-focused”. He explained this to mean that they would “seek to make judgments on the judgments of senior management and take actions if in our view those actions will lead to risks to our statutory objectives. This is a fundamental change. It is moving from regulation based only on observable facts to regulation based on judgments about the future”.

He emphasised that this would be an ‘intrusive’ and ‘direct’ style of supervision (which he called ‘the intensive supervisory model’) and stated that this would be allied with a more proactive approach to enforcement termed “our credible deterrence philosophy”.

Finally, Mr. Sants issued a stark warning: “There is a view that people are not frightened of the FSA. I can assure you that this is a view I am determined to correct. People should be very frightened of the FSA”.

[http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312\\_hs.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312_hs.shtml)

## **FSA Publishes Wide-Ranging Regulation Review**

On 18 March, the FSA published the *Turner Review: a regulatory response to the global banking crisis*, together with Discussion Paper 09/02, which sets out the FSA's specific proposals. Together they form an exceptionally important regulatory initiative. Clearly the timing was designed to influence the G-20 Summit that took place in London, chaired by the UK, in early April.

The Turner Review considers the underlying causes of the current financial crisis and in recommending a regulatory response stresses the importance of future regulation and supervision being based on a different approach. Among its recommendations are:

- fundamental changes to bank capital and liquidity regulations and to bank published accounts, enhanced capital requirements to support risky trading activity, and counter-cyclical capital buffers;
- increased reporting requirements for unregulated financial institutions such as hedge funds;
- regulation of credit rating agencies;
- regulation of remuneration policies;
- major changes in the FSA's approach to supervision and regulation (building on the new approach described in the speech of FSA Chief Executive Hector Sants, as reported above);
- more emphasis on macro-prudential supervision; and
- more emphasis on counter-cyclical controls.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/037.shtml>

## **FSA Publishes Consultation Paper on Remuneration**

The FSA has published a consultation paper (CP 09/10 *Reforming remuneration practices in financial services*) which puts forward a draft Code of Practice (Code) on remuneration and formally consults on applying it to a group of 45 large banks and broker dealers and incorporating it into the FSA rules. The CP invites discussion on the possibility that the Code should be applied to all FSA-authorised firms.

The draft Code's basic requirement which would become an FSA rule is that "a firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management". The FSA proposes that the Code's remaining ten principles should be put into the FSA rule book as guidance as to the evidence the FSA will focus on when assessing compliance with the Code.

The CP notes that in order to be effective, remuneration policies need to be implemented in a consistent global manner. In deciding whether and when to implement its proposals, the FSA will take into account whether it considers that there has been satisfactory alignment of implementation plans with respect to remuneration policies by regulatory authorities in other major financial centers.

The consultation period on implementation of the Code for larger banks and broker dealers lasts until 18 May. The period for discussion and feedback on whether to extend the Code to other regulated firms ends on 18 June.

[http://www.fsa.gov.uk/pages/Library/Policy/CP/2009/09\\_10.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_10.shtml)

## **Guilty Verdict Obtained in First FSA Criminal Insider Dealing Case**

On 27 March, a lawyer and his father-in-law were found guilty of insider dealing in the first insider dealing criminal prosecution brought by the FSA. Each received an eight month jail sentence. The FSA has begun to bring criminal insider dealing cases as part of its tougher approach to tackling market abuse. Three further cases are currently pending.

The jury found that Christopher McQuoid, the general counsel at TTP Communications (TTP) had passed inside information to his father-in-law who traded and made a profit using the information. The FSA has obtained a court order freezing the profits made from the trade.

Margaret Cole, the FSA's director of enforcement stated: "By pursuing a criminal prosecution in this case, the FSA has shown that we will take tough action to achieve our aim of credible deterrence in the financial markets. Mr. McQuoid took advantage of the trust placed in him as TTP's legal counsel, and with his father-in-law, has been found guilty of cheating the

market. Anyone engaging in similar acts should see this as a clear warning that the FSA intends to bring all its powers to bear to protect the integrity of our markets”.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/042.shtml>

### **FSA Campaign Against Insider Dealing Continues**

On 31 March, the FSA announced that it had arrested a “senior corporate finance adviser” and another individual in connection with an ongoing investigation into suspected organised insider dealing. Search warrants were also executed by the FSA at a number of addresses in Greater London as part of the investigation. The FSA announced that its arrest operation involved 25 FSA staff, assisted by 11 police officers.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/045.shtml>

### **FSA Wins Market Abuse Case Against Market Maker**

On 2 April, the FSA announced that it had won its market abuse case at the Financial Services and Markets Tribunal (the Tribunal) against Winterflood Securities Limited (Winterflood), the largest market maker of AIM Securities, and two Winterflood traders, Stephen Sotiriou (SS) and Jason Robins (JR).

In June 2008, the Regulatory Decisions Committee of the FSA (RDC) found that Winterflood, JR and SS carried out an illegal share ramping scheme relating to shares in Fundamental-E Investments Plc (FEI), an AIM listed company. In particular, the market maker had misused rollovers and delayed rollovers thereby creating a distortion in the market for FEI shares and in so doing misled the market for about six months in 2004. The RDC fined Winterflood £4 million and imposed fines of £200,000 on SS and £50,000 on JR.

The RDC concluded that the FEI share trades executed by Winterflood in the relevant period had a series of unusual features which should have alerted the market maker to the clear and substantial risks of market manipulation. Rather than taking steps to ensure that the trades were genuine, Winterflood continued the trading since it was highly profitable. Winterflood made about £900,000 from trading in FEI shares in the relevant period. FEI was its most profitable stock at the time.

Winterflood referred the matter to the Tribunal on a point of law. The Tribunal rejected Winterflood’s contentions and upheld the RDC’s decision which has therefore now been made public.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/046.shtml>

## **EU Developments**

### **European Commission Consults on Major Changes to Financial Services Regulation**

On 10 March, the European Commission launched a consultation *Driving European Recovery* on major structural changes to European financial services and markets regulation. The Commission intends by the end of May to publish a communication setting out its proposals on the future of the EU supervisory architecture followed by numerous specific legislative measures before autumn 2009. At this stage, it is seeking the views of interested parties. The Commission requests the submission of comments by 10 April.

The Commission endorses the key principles set out in the recent *de Larosière Report* and calls for a supervisory system combining stronger oversight at the EU level with maintaining a key role for national supervisors. Its proposals here contrast with the de Larosière recommendations, which focused on EU level supervision.

The Commission will propose an ambitious new reform program, designed to deliver “responsible and reliable financial markets for the future”. The reform program will have five key objectives:

1. To provide the EU with a supervisory framework that detects potential risks early, deals with them effectively before they have an impact, and meets the challenge of complex international financial markets. The Commission will present a European financial supervision package before the end of May 2009.

2. To fill gaps where European or national regulation is insufficient or incomplete, based on a 'safety first' approach. In particular, the Commission will propose:
  - A comprehensive legislative instrument establishing regulatory and supervisory standards for hedge funds, private equity and other systemically important market players (April 2009)
  - A white paper on tools for early intervention to prevent a crisis (June 2009)
  - On the basis of a report on derivatives and other complex structured products (June 2009), appropriate initiatives to increase transparency and ensure financial stability
  - Legislative proposals to increase the quality and quantity of prudential capital for trading book activities and tackle complex securitisation (June 2009) and to address liquidity risk and excessive leverage (Autumn 2009)

There will also be proposals:

3. To ensure that European investors, consumers and small and medium-sized enterprises can be confident about their savings, access to credit and their rights as concerns financial products.
4. To improve risk management in financial firms and align pay incentives with sustainable performance.
5. To ensure more effective sanctions against market wrongdoing.

The *de Larosière Report* can be found at:

[http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf)

*Driving European Recovery* can be found at:

[http://ec.europa.eu/commission\\_barroso/president/pdf/press\\_20090304\\_en.pdf](http://ec.europa.eu/commission_barroso/president/pdf/press_20090304_en.pdf)

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More information on the consultation is available at:

[http://ec.europa.eu/internal\\_market/consultations/2009/fin\\_supervision\\_en.htm](http://ec.europa.eu/internal_market/consultations/2009/fin_supervision_en.htm)

## For more information, contact:

	Direct Dial	Email
Martin Cornish	+44 (0) 20 7776 7622	<a href="mailto:martin.cornish@kattenlaw.co.uk">martin.cornish@kattenlaw.co.uk</a>
Edward Black	+44 (0) 20 7776 7624	<a href="mailto:edward.black@kattenlaw.co.uk">edward.black@kattenlaw.co.uk</a>

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**KattenMuchinRosenmanCornish LLP**

[www.kattenlaw.co.uk](http://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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