



London Update

UK Financial Services Regulatory Developments

February 2007

UK Implementation of MiFID

Statutory Instruments prepared by the UK's HM Treasury for implementation of the EU Markets in Financial Instruments Directives (MiFID) were published early in 2007 and included:

- amendments to the UK Regulated Activities Order replacing the existing Investment Services Directive override, introducing a new regulated activity of operating a multilateral trading facility (MTF) and extending the scope of specified investments to include new financial instruments (including options and futures on all commodities and various other non-financial products and contracts for differences based on credit derivatives;
<http://www.opsi.gov.uk/si/si2006/20063384.htm>
- amendments to the UK Exemption Order referring to the activity of operating an MTF, exempting European Economic Area authorised operators of regulated markets of MTFs, and disapplying certain exemptions where the person who would benefit is an investment firm or credit institution carrying on an activity within the scope of MiFID;
http://www.opsi.gov.uk/si/si2006/draft/ukdsi_0110755537_en.pdf
- introduction of the MiFID passport and setting out prescribed information requirements, minimum conditions on firms and requirements firms must satisfy before any significant change to their operations;
<http://www.opsi.gov.uk/si/si2006/20063385.htm>
- recognition requirements for investment exchanges and clearing houses to partly implement MiFID provisions relating to the organisation and operation of derivative and stock exchanges;
<http://www.opsi.gov.uk/si/si2006/20063386.htm>
- provisions for amending the UK appointed representatives regime to accommodate MiFID tied agents and to provide certain exemptions from the general prohibition in respect of the placing of financial instruments and advising in respect of such placings and requiring representatives to be entered on a register; and
http://www.opsi.gov.uk/si/si2006/uksi_20063414_en.pdf
- introduction of confidential information regulations that make minor changes to the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Order 2001.
http://www.opsi.gov.uk/si/si2006/uksi_20063413_en.pdf

Two further Instruments will follow and additional changes implementing MiFID will be included in the UK's Financial Services Authority rules.

“MiFID Connect” Issues Draft Guidelines on UK Implementation of MiFID

On January 11, the British Bankers Association (BBA) published draft guidelines prepared by the industry group MiFID Connect in respect of the proposed rules for the implementation of the Markets in Financial Instruments Directive in the UK. The guidelines will be subject to review by the UK Financial Services Authority (FSA) and may be revised further by MiFID Connect once the final rules on MiFID implementation are published by the FSA at the end of January. The MiFID Connect guidelines cover: (i) investment research; (ii) suitability and appropriateness; (iii) best execution; (iv) conflicts of interest; and (v) outsourcing.

<http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=600&a=8158>

FSA Announces Financial Crime and Intelligence Division

The Financial Services Authority ("FSA") announced on January 22 that it had established a new Financial Crime and Intelligence Division with an initial staff of 55. The division, headed by Philip Robinson, former FSA Head of Regulatory Transactions, will focus on the risks posed by financial crime to the UK's financial sector -- particularly from breaches of information security and other "high tech" crime. The division will, in conjunction with other regulators and law enforcement agencies: (1) examine the risks facing consumers from increasing information security; (2) measure the impact of financial crime; and, (3) identify, assess and manage criminal threats in the UK's financial sector.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/008.shtml>

Treasury Consultation on Draft Money Laundering Regulations

The UK Treasury published a second consultation document on its draft Money Laundering Regulations 2007 (designed to implement the European Union's Third Money Laundering Directive) on January 22. This is a follow-up to an initial consultation in July 2006 and includes a revised regulatory impact assessment as well as the full text of the draft regulations. The Directive is required to be implemented by 15 December 2007.

http://www.hm-treasury.gov.uk/consultations_and_legislation/money_laundering_directive/consult_thirdmoney_2007.cfm

W Deb MVL Plc Fined for Systems and Controls Inadequacies

The UK FSA has fined W Deb MVL Plc (WDM) £560,000 (approximately \$1.1 million) for widespread failings in its systems and controls during the four and a half years between December 2001 and May 2005.

The primary result of its failures was that WDM was unable to monitor its own financial position or to comply with its financial reporting requirements. This led to it making total provisions of £66.3 million (at today's exchange rate approximately \$129.3 million) in its accounts for 2004 and 2005 in respect of assets viewed as irrecoverable. These provisions in turn led to concerns about the firm's solvency and to its former parent company waiving loans totalling £58 million (\$113 million) to ensure it remained adequately capitalised. (WDM has since been sold in an agreed manner that would allow for the orderly migration of the business and formal close down of the firm and its business being wound up by its new parent company)

The FSA found that WDM had breached several of the FSA Principles for Business as well as relevant FSA rules on client money as it had:

- failed to act appropriately on repeated warning signals about the systems and controls failings identified by both internal and external auditors over a four and a half year period (Principle 2);
- failed to establish and maintain accurate accounting records capable of producing the required statutory accounting and regulatory reports (Principle 3);
- failed to establish and maintain adequate systems and controls and/or records in relation to its accounts, cash balances and stock positions; (Principle 3);
- failed to establish and maintain effective client money procedures leading to its failure to carry out the calculation and segregation of client money for the period from 1 November 2004 to 31 March 2005 and failed to inform the FSA it had not carried out the client money calculation for that period (Principles 3, 10 and 11).

Although there was no evidence that any clients had suffered any actual loss, the nature and extent of the firm's failings warranted a substantial fine. By agreeing to settle at an early stage of the FSA investigation WDM qualified for a 30% discount under the FSA's Executive Settlement Scheme as a result of which the fine was reduced from £800,000 to £560,000. In determining the level of penalty the FSA also took account of the fact that WDM and its former parent identified potential regulatory issues at the firm in 2005 and acted properly and responsibly in reporting these to the FSA. Further WDM and its former parent (as well as its new parent) had been open and co-operative with the FSA in bringing the matter to a prompt conclusion.

http://www.fsa.gov.uk/pubs/final/wdeb_15jano7.pdf

Assets Recovery Agency to Merge with SOCA in 2008

Under the Serious Crime Bill published on 17 January 2007, the UK Government will merge the Assets Recovery Agency (“ARA”) with the UK’s Serious Organised Crime Agency (“SOCA”). SOCA was set up last year with a view to becoming the UK’s equivalent to the FBI. The ARA, which cost £60m to set up and aimed to reclaim ill-gotten gains from criminals, is to be merged with SOCA after recovering just £8.3m in four years. This merger is likely to happen in April 2008.

The power to launch civil recovery proceedings will also be extended to England & Wales’ three main prosecutors: the Crown Prosecution Service, the Revenue and Customs Prosecutions Office, and the Serious Fraud Office.

<http://www.publications.parliament.uk/pa/ld200607/ldbills/027/2007027.pdf>

FSA Publishes Rules to Implement EU MiFID Directive

On January 26, 2007, the Financial Services Authority (“FSA”) issued its final rules for the implementation of the EU Markets in Financial Instruments Directive.

MiFID is the single largest change in European financial services legislation since the EU Investment Services Directive (“ISD”) was introduced in 1995. MiFID’s aim is to allow financial services institutions in the EU to provide their services across EU borders more freely and to make it easier for entities incorporated in one EU member state to establish branches in other EU states. MiFID is a core part of the EU’s Financial Services Action Plan aimed at stimulating the adoption of common standards and promoting cross-border “passporting” of financial services throughout the EU.

MiFID involves significant changes which will affect the organisation and conduct of business of investment firms (key changes relate to best execution, conflicts of interest, client classifications and senior management responsibilities); operation of regulated markets; new pre-and post-trade transparency requirements for equity markets; the creation of a new regime for “systematic internalizers” of orders for securities- and more extensive transaction reporting requirements.

The UK met the EU’s January 31 “transposition” deadline for MiFID. The EU intended that all member states would have their rules in place to allow a nine month period for financial institutions to complete their plans for implementation of the new MiFID requirements ahead of November 1 when the provisions come into force. The only other EU member states to meet the deadline were Bulgaria and Rumania each of which only became EU members on January 1, 2007. It is not yet clear when the remainder of the EU and in particular the other jurisdictions with developed financial services industries will enact their transposition rules.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/013.shtml>

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Upcoming Breakfast Seminar:

Date: 13 March 2007

Venue: London Capital Club, London EC4

MiFID: The Details of UK Regulation

As reported in this London Update, the FSA and the Treasury have recently published the detailed regulatory framework which will govern UK investment business after MiFID comes into effect on 1 November 2007. In our seminar we will provide an overview of the key changes and their impact on areas such as financial promotions, suitability obligations, best execution, client classification, systems and controls and outsourcing.

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

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