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London Update

UK Financial Services Regulatory Developments

January 2009

This London Update *covers the period from 1 November to 31 December 2008*

UK Developments

FSA Fines MLRO and Firm for Money Laundering Failings

On 29 October, the UK Financial Services Authority (FSA) fined Sindicatum Holdings Limited (SHL) £49,000 ($78,000) and SHL's Money Laundering Reporting Officer (MLRO) £17,500 for inadequate anti-money laundering systems and controls between October 2003 and September 2007.

This is the first time that the FSA has imposed an individual penalty on a regulated firm's MLRO. The FSA found that the MLRO failed to take reasonable steps to implement adequate anti-money laundering procedures for verifying and recording clients' identities.

In determining the amount of the financial penalties, the FSA took into account SHL's limited financial resources. Since September 2007, SHL and its MLRO have taken steps to improve the firm's systems and controls in relation to financial crime. The FSA stated that it had not found any evidence that any money laundering had actually taken place.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/125.shtml

FSA Calls for International Coordination to Stop Boiler Room Fraud

On 10 and 11 November, the FSA held its first "anti-boiler room" conference of international regulators and law enforcement agencies. Attended by representatives from 20 countries, the conference aimed to encourage a global response to this global problem. Since boiler room fraud operations are typically located in a different jurisdiction than their target investors, they can only be dealt with by coordinated information sharing and enforcement among national regulators.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/128.shtml

FSA Fines Two Individuals for Market Abuse

On 13 November, the FSA announced that it had fined Richard Ralph, former British ambassador to Peru and former executive chairman of AIM-listed mining company Monterrico Metals Plc (Monterrico), £117,691.41 and Filip Boyen £81,982.95 for market abuse. They had dealt in Monterrico's shares ahead of the takeover of Monterrico on the basis of inside information. The fines were made up of two elements: the disgorgement of the profit made by each of them, and additional penalties of £105,000 and £52,500, respectively.

Although it was publicly known that Monterrico was in takeover discussions, the details of the negotiations concerning the precise terms of the transaction, in which Mr. Ralph was closely involved, were confidential. Knowing he was not allowed to buy shares, Mr. Ralph asked Mr. Boyen to do so on his behalf. Mr. Boyen did so and also bought further shares for himself.

Each was fined for dealing based on inside information and for improperly disclosing inside information. The additional penalty for each was reduced by 30% based on their cooperation and early admission of liability. The FSA also stated that, but for that cooperation, it would "have seriously considered taking criminal proceedings."

www.fsa.gov.uk/pages/Library/Communication/PR/2008/133.shtml

FSA Reiterates Concern Over Spreading of Rumours

The FSA devoted most of issue 30 of its *Market Watch* newsletter (released on 19 November) to emphasising its concerns over the spreading of false or misleading rumours about listed companies.

The FSA considers that spreading false or misleading rumours about companies can be a "very damaging" form of market abuse, particularly in volatile market conditions. It has been carrying out this work in order to assess the policies and procedures firms have in place for dealing with rumours that circulate in the market.

In order to help firms address the issue, the FSA sets out in *Market Watch* 30 examples of good and poor practices identified from its thematic work with respect to rumours.

www.fsa.gov.uk/pubs/newsletters/mw_newsletter30.pdf

FSA Updates Short-Selling FAQs

On 26 November, the FSA published a further update to its short-selling FAQs. The only substantive change is in the answer to question 42, which provides additional detail on the interaction of the short-selling requirements relating to companies in rights issue periods and the requirements related to UK financial sector companies (where such companies enter into a rights issue period).

www.fsa.gov.uk/pubs/other/Short_selling_FAQs_V5.pdf

FSA Proposes Further Amendments to UK Listing Rules

On 1 December, the FSA published CP08/21, "Consultation on amendments to the Listing Rules and feedback on DP08/1," a feedback statement following its review of the UK listing regime published in January 2008. The paper proposes further changes to the UK regime so that relevant listing rules are clearly marked as "Premium" or "Standard" in order to ensure that issuers understand their obligations under the regime.

The requirements for a Standard listing (currently called a Secondary listing) are derived from the EU Prospectus Directive, Disclosure and Transparency Rules and Consolidated Admissions and Reporting Directive. Premium listings will have to meet UK standards that are super-equivalent to the EU requirements.

The proposed Standard listing will cover issues of equities (excluding issues by investment entities), Global Depository Receipts and Debt and Securitised derivatives, as such issues are only required to comply with EU minimum standards. The Premium segment will only be open to equity securities issued by commercial companies and closed- and open-ended investment entities. Premium and Standard listings will be available to both UK and overseas companies.

The FSA expects to provide further feedback this summer.

www.fsa.gov.uk/pubs/cp/cp08_21.pdf

UK Definition of "Financial Instrument" Harmonised

On 2 December, the definition of "financial instrument" found in Part 6 of the Financial Services and Markets Act 2000 and in Article 5 of the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Instruments) Order 2001 (SI 2001/996) was amended by the publication of the Definition of Financial Instrument Order 2008 (SI 2008/3053). The amendments ensure that the term "financial instrument" is understood by reference to its definition in the EU Market Abuse Directive and the EU Markets in Financial Instruments Directive (MiFID).

The definition is being amended to ensure that the UK remains fully compliant with its obligations under the EU Market Abuse Directive and MiFID. The provisions used to implement the UK's obligations under these directives need to be updated to ensure continued compliance with respect to subsequent amendments. The changes mean that the FSA's powers to make rules for the disclosure of information in relation to financial instruments will now extend to derivative instruments, which, although not giving a legal entitlement to acquire shares, in practice put their holders in an economically similar position. The most common example of this is a Contract for Difference (CfD), which currently falls outside the UK disclosure rules.

www.opsi.gov.uk/si/si2008/pdf/uksi_20083053_en.pdf

High Court Confirms FSA Powers to Prosecute Insider Trading

On 2 December, the Divisional Court of the High Court confirmed that the FSA may independently commence proceedings for suspected insider trading activities under section 402 of the Financial Services and Markets Act 2000 without obtaining the consent of the Director of Public Prosecutions (DPP) or the Secretary of State. The ruling clears the way for the FSA to continue with three high-profile criminal insider trading cases.

The appeal was brought by the defendant following a ruling in September by District Judge Purdy at the City of Westminster Magistrates Court in which the judge rejected defence arguments that the FSA needed to obtain the consent of the DPP or the Secretary of State to institute an insider dealing prosecution (as reported in the November 2008 edition of *London Update*).

FSA Proposes New Liquidity Rules

On 4 December, the FSA published consultation paper CP08/22, "Strengthening liquidity standards", proposing significant changes to its liquidity requirements for banks, building societies and investment firms.

The proposed rules are based on the Basel Committee on Banking Supervision's (BCBS) Principles for Sound Liquidity Risk Management and Supervision and other international agreements to address liquidity issues as a result of recent market events. The FSA proposals include: (i) a new liquidity risk management framework with greater emphasis on liquidity risk assessment and mitigation; (ii) a qualitative framework for liquidity risk management with an increased focus on stress testing and contingency funding; (iii) new liquidity reporting requirements; and (iv) a new approach for corporate groups operating in the UK.

The consultation period closes on March 4, and new rules are expected in October.

www.fsa.gov.uk/pubs/cp/cp08_22.pdf

LSE Publicly Censures AIM-Listed Company

On 4 December, the London Stock Exchange plc (LSE) imposed a public censure on Minmet plc (Minmet) for breaches of Rules 10, 11, 12, 13, 14 and 31 of its Alternative Investment Market (AIM) between October 2006 and January 2008.

The breaches were related to various transactions with respect to which Minmet failed to: (i) release announcements without delay regarding a reverse takeover and certain substantial and/or related party transactions; (ii) include material information in certain announcements; (iii) comply with the AIM Rules concerning reverse takeovers; and (iv) properly liaise with its AIM nominated adviser (Nomad).

www.londonstockexchange.com/NR/rdonlyres/85F0A46B-1F13-474C-B9FC-A2B1A022FA30/0/Minmetpubliccensure.pdf

FSA Amends Enforcement Guide

On 5 December, the FSA published policy statement PS08/13, "Decision Procedure and Penalties Manual and Enforcement Guide Review 2008".

The feedback statement summarises the responses received by the FSA to its consultation paper CP 08/10 on the same subject (see the October 2007 edition of *London Update*). Additionally, the feedback statement sets out the final amendments in the FSA's Decision Procedure and Penalties Manual (DEPP), the Regulated Covered Bonds Sourcebook (RCB) and the Enforcement Guide (EG).

Notably, the FSA has added a leniency factor to its non-exhaustive list of factors that it may take into account when deciding whether to commence a market misconduct prosecution. Where misconduct is carried out by two or more individuals acting in concert and one of those individuals provides the FSA with information and gives full assistance to the FSA, the FSA will take that cooperation into account when deciding whether to prosecute the individual who has provided assistance.

The amendments also introduce a new chapter in the EG describing the FSA's approach to using enforcement powers under UK legislation, including the Money Laundering Regulations 2007, and remove certain restrictions on the FSA's use of Own Initiative Variations of Permission.

The amendments to the DEPP, RCB and EG came into force on 11 December.

www.fsa.gov.uk/pubs/policy/ps08_13.pdf

EU Developments

From Financial Crisis to Recovery: A European Framework for Action

On 12 November, the European Commission published a communication document in which it set out a three part approach which it intends to develop into an overall EU recovery action plan/framework designed to take Europe's financial sector from crisis to recovery.

The Commission considers that the EU and Member States must tackle the next stages of the financial crisis in a united, coordinated manner, turning the challenges presented by the crisis into opportunities. The Commission's proposed three part approach involves:

- the creation of a new financial market architecture at EU level,
- dealing with the impact of the financial crisis on the real economy, and
- a global response to the financial crisis.

www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0706:FIN:EN:PDF

European Commission Adopts Proposal for Regulation of Credit Rating Agencies

On 13 November, the European Commission proposed a series of measures for the regulation of credit rating agencies targeting conflicts of interest and the transparency of the activities of credit rating agencies, and mandating specific standards for certain aspects of the rating agencies' methodologies.

Under specific proposals, credit rating agencies:

- may not provide advisory services;
- will not be allowed to rate financial instruments if they do not have sufficient quality information on which to base their ratings;
- must disclose the models, methodologies and key assumptions on which they base their ratings;
- will be obliged to publish an annual transparency report;
- will be required to create an internal function to review the quality of their ratings; and
- will be required to have at least three independent directors on their boards of directors: (i) whose remuneration must not depend on the business performance of the rating agency; (ii) who are appointed for a single term of office of five years or less; (iii) who may only be dismissed for professional misconduct; and (iv) at least one of whom is an expert in securitisation and structured finance.

www.ec.europa.eu/internal_market/securities/agencies/index_en.htm

European Commission Consults on Hedge Fund Regulation

On 17 December, the European Commission published a consultation paper seeking views on whether regulation and supervision of hedge funds should be reassessed. The consultation follows from an initiative of the European Parliament demanding regulation of hedge funds and private equity funds and instructing the Commission to propose legislation (see the November 2008 edition of *London Update*).

The consultation seeks views on whether it is necessary to: (i) increase the capacity of the current regulatory framework to monitor and react to risks originating in the hedge fund sector; (ii) reassess the systemic relevance of hedge funds; (iii) address market integrity and efficiency issues including short selling and limits on leverage; (iv) improve management of market risks in areas including asset valuations and conflicts of interest; and (v) provide greater transparency to investors and increase investor protection.

Also, in relation to a number of the consultation points, the Commission asks how an appropriate regulatory initiative should be designed to complement and reinforce existing industry codes. The Commission considers that any adjustment to the current "policy stance as regards hedge funds" should be part of the overall EU review of the regulatory and supervisory framework in financial markets and its comprehensive policy response to the current financial crisis.

The responses to the consultation will also serve as the basis for the EU's contribution to the consideration of similar issues by the G-20 and International Organization of Securities Commissions. The consultation closes on 31 January. Feedback from the consultation will be discussed at a high-level conference to be held in Brussels in late February.

www.ec.europa.eu/internal_market/consultations/docs/hedgefunds/consultation_paper_en.pdf

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