



## London Update

### UK Financial Services Regulatory Developments

July 2008

*This edition of London Update covers UK and EU developments from 29 April to 30 June 2008.*

### UK Developments

#### **FSA Publishes *Market Watch* 26**

On 29 April, the Financial Services Authority (FSA) published issue 26 of its *Market Watch* newsletter, focusing on market conduct and transaction monitoring issues. It provides an overview of the FSA's strategy for tackling market abuse such as insider dealing through the use of "credible deterrence." *Market Watch* 26 reiterates the FSA's enforcement approach and in particular warns again that severe sanctions will be imposed by the FSA for market abuse. As part of its anti-market abuse strategy, the FSA will undertake a thematic review of FSA authorised firms' policies in relation to the dissemination of false market rumours.

*Market Watch* 26 also highlights that in 2006 and 2007, "informed price movements" preceded significant announcements related to FTSE 350 companies and public takeovers in 28.6% and 28.7% of cases respectively. This represents an increase from 23.7% in 2005. The FSA considers that these statistics do not necessarily correlate to the level of insider dealing, as they may also indicate: (i) financial analysts and the media correctly assessing which companies are likely takeover targets; (ii) deliberate "strategic" leaks of information by a company to position a deal in the marketplace; or (iii) trades by "informed" traders who picked up or derived information from the trades of insiders.

[www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter26.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter26.pdf)

#### **FSA Considers Increasing Regulatory Transparency**

On 27 May, the FSA published a discussion paper, *DPo8/3 Transparency as a Regulatory Tool*, setting out a proposed code of practice to provide guidance as to the circumstances in which the FSA may release information to the public. The discussion paper recognises that the FSA operates within certain constraints imposed by the UK Freedom of Information Act 2000 and the Financial Services and Markets Act 2000. Under these statutes, the FSA must safeguard confidential information and follow due process before it can publish a statement which amounts to a "public censure" of an FSA authorised firm. However, the FSA believes that it should make information public where it is legally able to do so and where it will help the FSA to achieve its statutory objectives.

The discussion paper provides examples of the types of information the FSA may consider publishing and draws a clear distinction between simply making information available, which the FSA concedes could cause confusion and potentially have a negative impact, and publishing information in a way that makes issues and practices clearer and therefore improves how regulated markets function.

The deadline for comments is 29 August.

[www.fsa.gov.uk/pubs/discussion/dpo8\\_o3.pdf](http://www.fsa.gov.uk/pubs/discussion/dpo8_o3.pdf)

#### **FSA Launches Consultation on Amending Enforcement Procedures**

On 27 May, the FSA published consultation paper *CPo8/10 Decision Procedure and Penalties Manual and Enforcement Guide Review 2008*. This follows the introduction of the FSA's new Decision Procedure and Penalties (DEPP) Manual and Enforcement Guide (EG) in July 2007 and is part of its commitment to annually review such materials.

The consultation paper includes a proposed new chapter to the EG which would include the FSA's policy on new enforcement powers, particularly with respect to anti-money laundering and covered bonds. The FSA is seeking powers to impose civil penalties for breaches of these regulations and it intends to apply similar investigative procedures to money laundering regulatory breaches as it does to other matters under its jurisdiction.

The consultation paper includes a proposal to provide a greater incentive for suspects to cooperate with the FSA. In circumstances where misconduct is carried out by two or more individuals acting together and one cooperates with the FSA, this will be taken into account by the FSA when deciding whether to prosecute or to bring market abuse proceedings. The FSA proposes to amend the non-exhaustive list of factors it will take into account when considering leniency to include cooperation and assistance.

The consultation closes on 29 August.

[www.fsa.gov.uk/pubs/cp/cpo8\\_10.pdf](http://www.fsa.gov.uk/pubs/cp/cpo8_10.pdf)

### **FSA Granted Limited Permission to Appeal Financial Promotion Decision**

On 29 May, the Financial Services and Markets Tribunal (FSMT) published the written reasons for its decision of 23 April in respect of an application by the FSA for permission to appeal FSMT judgments from September 2007 and March 2008. The FSMT judgments were related to UK law firm Fox Hayes and its approval of financial promotions.

The FSMT decision grants the FSA limited permission to appeal certain points of law to the Court of Appeal. These include the interpretation of what is "clear, fair and misleading" under the FSA Rules and the interpretation of conducting an investment business with "due skill, care and diligence."

[www.financeandtaxtribunals.gov.uk/Documents/decisions/FinancialServicesMarketsTribunal/058\\_FoxHayesPermissionToAppeal.pdf](http://www.financeandtaxtribunals.gov.uk/Documents/decisions/FinancialServicesMarketsTribunal/058_FoxHayesPermissionToAppeal.pdf)

### **FSA Launches Action to Close Down Illegal Landbanking Scheme**

On 4 June, the FSA announced that it had applied to the UK High Court for an order to wind up the UK's largest "landbanking" company, UKLI Limited (UKLI), for operating as an illegal collective investment scheme, i.e., a fund, and denying its investors protection for their money.

The FSA was granted an interim freezing and restraining order against UKLI to protect assets for creditors, including investors, and to prevent UKLI from continuing to operate as an illegal fund.

[www.fsa.gov.uk/pages/Library/Communication/PR/2008/052.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/052.shtml)

### **Update on the Thematic Review of Controls Over Inside Information**

On 5 June, the FSA published *Market Watch 27* as an update of the FSA's thematic review of controls over inside information related to public takeovers.

In July 2007, the FSA had highlighted (in *Market Watch 21*) areas for firms to focus on to reduce leakage of inside information such as restricting the number of insiders, taking action when leaks occur, ensuring that there are robust IT controls, improving training and monitoring internal personal account dealing policies.

*Market Watch 27* includes examples of good industry practice and sets out Principles of Good Practice for the handling of inside information drawn up by industry practitioners. These Principles are voluntary and are designed to address the issues raised by *Market Watch 21*.

[www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter27.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter27.pdf)

### **UK Super-Equivalent Market Abuse Provisions to Be Retained**

On 6 June, HM Treasury published comments from its consultation regarding the provisions of the UK's market abuse regime which are "super-equivalent" to the regime under the EU Market Abuse Directive. The consultation was conducted between February and May 2008, as reported in the March 2008 edition of *London Update*.

The key super-equivalent provisions of the UK regime are section 118(4) (misuse of information) and section 118(8) (behaviour likely to give rise to false or misleading impressions or to distort the market) of the Financial Services and Markets Act 2000.

These so-called sunset or limited lifespan provisions were originally set to expire on 30 June 2008 unless extended. Following the Treasury's consultation, it is now proposed to extend the super-equivalent provisions until 31 December 2009.

[www.hm-treasury.gov.uk/media/8/C/consult\\_fsma\\_marketabuse\\_responses060608.pdf](http://www.hm-treasury.gov.uk/media/8/C/consult_fsma_marketabuse_responses060608.pdf)

## **Woolworths Fined £350,000 for Breaches of Disclosure Rules and Listing Principles**

On 11 June, the FSA fined Woolworths Group Plc £350,000 (\$700,000) for failing to disclose information to the market in a timely manner.

Woolworths became aware of a variation to the terms of a major supply contract of one of its subsidiaries, Entertainment UK (EUK) in December 2005, which led to an estimated £8 million reduction in Woolworths' profits for the year 2006–2007. The FSA considered this to be information that should have been disclosed to the market as soon as possible, as it was likely to have a significant effect on Woolworths' share price. The FSA took the view that Woolworths' failure to identify and disclose this information created a false market in its shares, which breached Disclosure Rule 2.2.1 and Listing Principle 4, the aim of which is to ensure that all market users get the same information at the same time.

[www.fsa.gov.uk/pages/Library/Communication/PR/2008/056.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/056.shtml)

## **FSA Introduces Disclosure Regime for Significant Short Positions in Companies Undertaking Rights Issues**

On 13 June, the FSA announced that with effect from 20 June, it "will require the disclosure of significant short positions in stocks admitted to trading on prescribed markets which are undertaking rights issues."

These new disclosure requirements, which have been inserted into the FSA's Code of Market Conduct, require the disclosure of short positions of 0.25% or more of the issued shares of a relevant issuer achieved via short selling or by any instruments giving rise to an equivalent economic interest, such as contracts for differences, swaps or options.

Failure to give the required disclosure will constitute market abuse under the FSA's Code of Market Conduct, which applies to all market participants, not just to FSA regulated firms.

The FSA also stated that it is considering the possibility of introducing further measures including: restricting lending of stock of securities in rights issues for the purposes of enabling short selling, and restricting short sellers from covering their positions by acquiring the rights to the newly issued shares.

[www.fsa.gov.uk/pages/Library/Communication/PR/2008/057.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/057.shtml)

[www.fsa.gov.uk/pubs/press/PNo572008\\_instrument.pdf](http://www.fsa.gov.uk/pubs/press/PNo572008_instrument.pdf)

## **Companies Act 2006: Application of Accounting and Audit Provisions to Limited Liability Partnerships**

On 16 June, the draft regulations prepared by the UK Department for Business, Enterprise & Regulatory Reform applying the accounts provisions of the Companies Act 2006 (the Act) to Limited Liability Partnerships (LLPs) were laid before the UK Parliament. The draft regulations included the following:

- Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008, which specify the form and content of the accounts for large and medium-sized LLPs to be filed with the Registrar of Companies;
- Limited Liability Partnerships (Accounts and Audit) (Application of the Companies Act 2006) Regulations 2008, which apply to LLPs various of the Act's provisions on accounts and audit;
- Small Limited Liability Partnerships (Accounts) Regulations 2008, which specify the form and content of accounts for small LLPs to be filed with the Registrar of Companies; and
- Limited Liability Partnerships (Late Filing Penalties) Regulations 2008, which set out the penalties for late filing of accounts and reports with the Registrar of Companies.

These regulations are due to come into effect for LLPs in the UK and Northern Ireland on 1 October 2008 for financial years beginning on or after that date.

[www.opsi.gov.uk/si/si2008/draft/pdf/ukdsi\\_9780110818351\\_en.pdf](http://www.opsi.gov.uk/si/si2008/draft/pdf/ukdsi_9780110818351_en.pdf)

[www.opsi.gov.uk/si/si2008/draft/pdf/ukdsi\\_9780110818337\\_en.pdf](http://www.opsi.gov.uk/si/si2008/draft/pdf/ukdsi_9780110818337_en.pdf)

[www.opsi.gov.uk/si/si2008/draft/pdf/ukdsi\\_9780110818344\\_en.pdf](http://www.opsi.gov.uk/si/si2008/draft/pdf/ukdsi_9780110818344_en.pdf)

[www.opsi.gov.uk/si/si2008/pdf/uksi\\_20080497\\_en.pdf](http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080497_en.pdf)

## **FSA Publishes Feedback on Treatment of Investments in Subsidiaries**

On 17 June, the FSA published *FSo8/4 Review of the interaction of our solo and group capital requirements* with feedback to its previous discussion paper DP07/5, published in September 2007.

The feedback statement accepted that market forces alone are unlikely to deliver the FSA's desired risk appetite in relation to capital adequacy of individual firms within a group. In DP07/5, the FSA set out its belief that other approaches such as replacing solo requirements with a form of group support or modifying the existing solo capital requirements should be considered to address market failure in a more proportionate manner than under the current deductions regime. The FSA has now concluded that it does not have conclusive evidence to support a change to the current regime and it will not alter the current solo or group capital requirements at this time.

In view of the responses to DP07/5, the FSA has decided that the treatment of investments in subsidiaries will now fall within the scope of a wider consideration of regulatory capital launched in December 2007 (*DP07/6 Definition of Capital*) and further feedback is expected later this year.

[www.fsa.gov.uk/pubs/discussion/fso8\\_o4.pdf](http://www.fsa.gov.uk/pubs/discussion/fso8_o4.pdf)

## **FSA Publishes Market Watch 28**

On 19 June, the FSA published issue 28 of its *Market Watch* newsletter. The newsletter included further information on: (i) the FSA's new telephone and electronic recording rules; (ii) client categorisation with respect to private placing; (iii) systems and controls for the prevention of market abuse in commodity firms; (iv) issues with debt capital markets businesses; and (v) transaction reporting.

The FSA's telephone and electronic recording rules are due to come into effect in March 2009, as reported in the April 2008 edition of *London Update*. The newsletter states that the FSA may ask authorised firms to retain recordings for longer than the six months provided in the rules where it considers that the recordings might assist the FSA in a market abuse investigation.

The FSA has also clarified the application of its client categorisation and financial promotion rules with respect to a private placing and has provided feedback on anti-market abuse systems and controls following its market abuse thematic project with firms that trade (or facilitate trading) in UK exchange-traded commodities markets.

The newsletter called for authorised firms to undertake a review of their systems and controls in relation to public and private side interaction within their debt capital markets businesses.

Finally, the FSA confirmed in the newsletter that it will not require authorised firms to report transactions in non-securities derivatives admitted to trading on regulated markets.

[www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter28.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter28.pdf)

## **LSE Censures and Fines Firm for Breaches of AIM Rules**

On 19 June, the London Stock Exchange (LSE) announced that it had publicly censured and fined Meridian Petroleum plc £75,000. Meridian breached the rules of the Alternative Investment Market (AIM) by repeatedly failing to take reasonable care to ensure announcements made to the market between August 2004 and February 2007 were not misleading and by failing to update the market.

[www.londonstockexchange.co.uk/NR/exeres/8C1B6C5D-7315-482D-BF8C-51AC4EBF7EC9.htm](http://www.londonstockexchange.co.uk/NR/exeres/8C1B6C5D-7315-482D-BF8C-51AC4EBF7EC9.htm)

## **FSA Bankrupts Boiler Room Controller**

On 26 June, the FSA announced that it obtained a bankruptcy order against Samuel Nathan Kahn, who controlled the affairs of Chesteroak Limited (Chesteroak) and Bingen Investments Limited (Bingen). Chesteroak and Bingen were two UK-based companies that helped illegal offshore boiler rooms sell shares to investors.

The bankruptcy order follows the liquidations of Chesteroak and Bingen in September 2007 after the FSA alleged that they were dealing in shares or arranging deals in shares without authorisation.

[www.fsa.gov.uk/pages/Library/Communication/PR/2008/060.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/060.shtml)

## EU Developments

### **European Parliament Considers Changes to Hedge Fund and Private Equity Regulation**

At a meeting held from 5-6 May, the European Parliament's Committee on Economic and Monetary Affairs (ECON) considered a draft report on hedge funds and private equity prepared by Poul Rasmussen, President of the Party of European Socialists (PES). PES forms part of the Socialist Group in the European Parliament, which has 216 Members in the European Parliament.

The draft report, which builds on a previous report by PES published in April 2007, formally requests that the European Commission submits to the European Parliament legislative proposals on hedge funds and private equity funds by 30 November 2008. The report proposes a set of measures to promote increased financial stability, ensure more transparency, prevent conflicts of interest, and reduce excessive debt.

The proposals include: (a) a single EU framework for transparency, registration and authorisation for managers of hedge and private equity funds including an EU-wide private placement regime; (b) new capital requirements for fund managers and prime brokers; (c) protections against capital depletion; (d) an EU Public Credit Agency (to replace privately owned credit rating agencies for the purposes of capital adequacy calculations); (e) a public register for complex, structured credit products; and (f) a single European Financial Supervisor covering all financial sectors to increase cooperation between national supervisory bodies and oversee cross-border and European-wide activities.

PES believes that there is insufficient regulation of hedge funds and private equity and that the European Commission has been biased in its "light touch regulation" approach. Although PES recognises that there are benefits to both hedge funds and private equity funds, PES believes that additional regulation is required to minimise the risk of future financial crises given that the European market is highly inter-related.

Under the EU's "co-decision" procedure (Article 251 of the EC Treaty), the European Parliament (and ECON) can only suggest legislation. Only the European Commission may propose actual legislation. Although ECON has suggested legislative changes to the regulation of hedge funds and private equity funds on four previous occasions between 2004 and 2007, the European Commission declined to act on any of these suggestions.

At ECON's public hearing on 8 April 2008 in respect of hedge funds and private equity funds, Dan Waters, the FSA's Director of Retail Policy, argued against introducing a new regime. He made the general point that the FSA "consider[s] that there is currently effective and proportionate regulation of hedge funds in Europe and no need for additional, potentially intrusive intervention."

[www.europarl.europa.eu/meetdocs/2004\\_2009/documents/pr/718/718451/718451en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/pr/718/718451/718451en.pdf)

[www.europarl.europa.eu/meetdocs/2004\\_2009/documents/dt/714/714525/714525en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/dt/714/714525/714525en.pdf)

### **CESR Consults Third Set of Market Abuse Guidance**

On 20 May, the EU Committee of European Securities Regulators (CESR) launched a consultation on its third set of guidance on the operation of the EU Market Abuse Directive (MAD). The draft guidance on MAD set out in the consultation covers issues relating to insider lists and suspicious transaction reporting (STR). CESR intends to publish a further consultation on guidance covering issues relating to stabilisation and the notion of inside information later this year. Guidance related to directors' dealings and the definition of inside information in the context of commodity derivatives will be addressed at a later stage.

The consultation closes on 30 September.

[www.cesr.eu/popup2.php?id=5054](http://www.cesr.eu/popup2.php?id=5054)

### **European Commission Calls for Strengthening of EU Level Three Committees**

On 23 May, the European Commission launched a consultation on possible amendments to the structure of each of the EU Level Three Committees: the EU Committee of European Banking Supervisors, the Committee of European Insurance and Occupational Pensions Supervisors and CESR.

The European Commission would like to align, clarify and strengthen the responsibilities of the three committees to improve EU supervisory cooperation and convergence and the safeguarding of financial stability.

The consultation invites comments on a range of issues including information exchange, delegation of tasks and responsibilities among national supervisors, colleges of supervisors, development of an EU-wide “common supervisory culture,” cooperation across sectors, and whether the committees should make decisions by consensus or by qualified majority voting.

The consultation closed on 18 July.

[ec.europa.eu/internal\\_market/finances/docs/committees/consultation\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/consultation_en.pdf)

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