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London Update

UK Financial Services Regulatory Developments

March 2007

FSA Publishes 2007-2008 Business Plan

The Financial Services Authority ("FSA") published its 2007-2008 Business Plan on February 6. The plan sets out FSA's priorities for the coming year and emphasizes that FSA's main strategic priority will be its "drive towards more principles-based regulation." Achieving this objective will require significant changes to the FSA's rules and the way it explains its regulatory requirements, as well as to its staff's skills and FSA's information systems.

The Business Plan includes FSA's full program of work and how it will be funded, including substantial additional spending on IT infrastructure. FSA's budget will rise by 10.1% (£27.6 million) from 2006-2007. This will be funded by increased fees for FSA regulated firms.

FSA's three strategic aims continue to be: (i) promoting efficient, orderly and fair markets; (ii) helping retail consumers achieve a fair deal; and (iii) improving business capability and effectiveness. The majority of FSA's work in the coming year will be dealing with the implementation of the EU Markets in Financial Instruments Directive ("MiFID") and the EU Capital Requirements Directive. FSA will also continue to be focused on themes such as Treating Customers Fairly, retail distribution, payment protection insurance and commission transparency in the insurance sector.

FSA remains committed to increasing efforts to prevent, detect and prosecute market abuse and other forms of financial crime. Enforcement action will continue to be an important strategic tool in supporting FSA's supervisory, thematic and market-monitoring activities. Internationally, FSA is planning to develop its relationship further with US regulatory authorities, including tests on handling financial crises which might affect both UK and US financial institutions and markets.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/019.shtml

Theft of Laptop Leads to £980,000 Fine for Nationwide

On February 14, the FSA announced that it had fined Nationwide Building Society £980,000 for a breach of FSA's Principle 3 (Systems and Controls) by failing adequately to assess the risks relating to information security and to take reasonable care to ensure that it had adequate procedures to manage those risks, including the risks that electronic equipment containing customer information might be lost or stolen. Further, Nationwide had inadequate controls in place to ensure that its procedures would be followed. The Principle which Nationwide was held to have breached provides that "A firm must take reasonable care to organize and control its affairs responsibly and effectively, with adequate risk management systems."

Nationwide is the UK's largest building society (broadly equivalent to a U.S. savings and loan association). It has over 11 million customers. In August 2006 a company laptop was stolen from the home of a Nationwide employee. The laptop contained confidential customer information which the FSA concluded could have been used to further financial crime. The FSA's November 2004 Information Security Report *Countering Financial Crime Risks in Information Security* specifically highlighted the need for firms to have incident management procedures commensurate with the size of their operations.

The FSA found that Nationwide's failure to implement robust systems and controls regarding the use and storage of customer information on portable storage devices potentially put its customers at an increased risk of being victims of financial crime in the event of loss or misuse of the data. Although Nationwide reported the loss of the laptop to the police, the Information Commissioner, and to the FSA, the FSA concluded that Nationwide's failure to respond quickly and appropriately in the first three weeks following the theft of the laptop in this case increased the opportunity for the information to be used in a way which might result in financial crime.

The FSA's findings included the following:

- Nationwide failed adequately to consider the wider risks to customer information from Nationwide systems being compromised and, as a result, it failed to put in place appropriate controls and monitoring mechanisms to mitigate these risks. The failure to manage or monitor downloads of very large amounts of data onto portable storage devices meant that Nationwide had limited control over information held in this way or how it was used, increasing the risk that it could be used to further financial crime.
- Nationwide's systems and controls were such that, when the laptop was stolen, Nationwide was not aware that it contained confidential customer information. For a period of three weeks after the theft of the laptop Nationwide failed to take any steps to investigate whether it contained such information.
- The cumulative impact of the failings represented a significant risk to the FSA objective of reducing the extent to which it is possible for regulated firms to be used for a purpose connected with financial crime.

In particular Nationwide:

- failed adequately to assess the risks in relation to the security of customer information;
- had procedures in relation to information security which failed adequately and effectively to manage the risks it faced;
- failed to implement adequate training and monitoring to ensure that its information security procedures were disseminated and understood by staff;
- failed to implement adequate controls to mitigate information security risks, to ensure that employees adhered to its procedures and to ensure that it provided an appropriate level of information security; and
- failed to have appropriate procedures in place to deal with an incident involving the loss of customer information and, as a result, Nationwide did not respond appropriately and in a timely manner to establish the risks to its customers of financial crime arising from the theft of the laptop.

By agreeing to settle at an early stage of the FSA's investigation, Nationwide qualified for a 30% discount under the FSA's executive settlement procedures. Without that discount the fine would have been £1.4 million.

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

AIM Raises Standards for Nomads and Issuers

On February 20, the London Stock Exchange introduced, with immediate effect, a new rule book for Nominated Advisers ("Nomads"), amended the AIM Rules for Companies to require additional disclosures (e.g. requiring issuers to maintain a website containing key financial and other information, including the issuer's AIM admission document) and amended the AIM Appeals and Disciplinary Handbook to increase the range and size of penalties it can impose on issuers and Nomads.

The new rule book *AIM Rules for Nominated Advisers* includes provisions which codify and expand a Nomad's role and responsibilities on matters including due diligence responsibilities with respect to issuers. It sets out in detail the tasks which the Nomad must carry out in order to meet its responsibilities to confirm to the exchange that a company is appropriate to be listed and to ensure that it is able to maintain ongoing compliance with AIM Rules.

www.londonstockexchange.com/aim/rulechanges2007

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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 last month's 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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