



## London Update

### UK Financial Services Regulatory Developments

March 2009

*This edition covers developments between 1 January and 28 February 2009*

#### UK Developments

##### **Modernisation of Insolvency Protections for Financial Markets**

On 29 December, the UK Treasury published a summary of responses to its consultation on its proposals to reform Part 7 of the UK Companies Act 1989 and related legislation. Part 7 of the Companies Act 1989 modifies the UK's general insolvency law to provide systemic protection for recognised investment exchanges and recognised clearing houses in the event of a default by one of their members.

Respondents generally supported the proposals which relate to: (i) provision for the operation of default funds and cross-margining arrangements; (ii) permitting the use of a defaulting member's house account surpluses to meet any client account deficits; (iii) an expansion of the definition of a "market contract"; (iv) provisions designed to ensure that client money provisions of other jurisdictions are honoured; and (v) the need to reflect certain amendments to UK insolvency law relating to administration.

The summary includes a technical explanation of the amendments made to the draft regulations as a result of responses to the consultation, and an annex contains the amended draft Financial Markets and Insolvency Regulations 2009.

[www.hm-treasury.gov.uk/consult\\_companiesact1989.htm](http://www.hm-treasury.gov.uk/consult_companiesact1989.htm)

##### **FSA Lifts Ban on Short Selling**

On 5 January, the UK Financial Services Authority (FSA) announced a consultation on a proposal to allow its ban on short sales of UK financial sector stocks to expire on 16 January. The FSA also proposed to extend its temporary disclosure regime for significant net short positions in UK financial sector company stocks to 30 June. The short position disclosure obligations will continue to apply only to UK financial sector companies.

The temporary ban on short selling of financial sector stocks was introduced in September 2008 (see the November 2008 edition of [London Update](#)). The FSA now considers that the risk posed by short selling in terms of potential market abuse and creating disorderly markets has declined such that it is not appropriate to renew the ban. However, the FSA emphasised that it will monitor the position closely and will reintroduce the short sales ban if it is warranted. If necessary, this will be done without further consultation.

On 14 January, the FSA confirmed that it will allow the ban on short selling stocks in UK financial sector companies to lapse with effect from 00:00:01 on 16 January.

The FSA also confirmed that it will extend its disclosure obligation for short selling of stocks in UK financial sector companies until 30 June (see above). Disclosure of a net short position in the stock of a UK financial sector company will continue to be required once a position reaches 0.25% of a relevant company's issued share capital and, with effect from 16 January, further disclosure is required if a short position changes by a further 0.10% of issued share capital.

The FSA intends to issue a further consultation paper with longer-term options for a UK short-selling regime shortly.

[www.fsa.gov.uk/pubs/cp/cp09\\_01.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_01.pdf)  
[www.fsa.gov.uk/pubs/policy/ps09\\_01.pdf](http://www.fsa.gov.uk/pubs/policy/ps09_01.pdf)

## **FSA Proposes to Amend Integrated Regulatory Reporting Regime**

On 6 January, the (FSA) published *Quarterly Consultation No 19* (CP09/2), which proposes amendments to Chapter 16 of the FSA's Supervision manual (SUP) relating to Integrated Regulatory Reporting requirements.

The proposed amendments follow enquiries and requests for clarification made to the FSA on its new reporting system known as "GABRIEL". The enquiries and requests identified some inconsistencies and duplications which the FSA now wishes to resolve. The proposed amendments affect the following provisions: (i) various rules and guidance set out at SUP 16.12.1R to SUP 16.12.33R; and (ii) SUP 16 Annex 24R (reporting forms) and SUP 16 Annex 25G (guidance on completing the forms).

The consultation period closed on 6 March.

[www.fsa.gov.uk/pages/Library/Policy/CP/2009/09\\_02.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_02.shtml)

## **FSA Launches Further Insider Dealing Prosecution**

On 7 January, the FSA charged Neil Rollins at the City of Westminster Magistrates' Court with insider dealing and money laundering offenses.

The FSA alleges that Mr. Rollins disposed of approximately 74,000 shares of PM Group plc between August and September 2006 while in possession of inside information and that he encouraged Louisa Rollins to deal in shares in the Group. The money laundering charges relate to the transfer of criminal property on various dates in November 2006 to an account in the name of David Rollins while knowing or suspecting that it represented the proceeds of insider trading.

The Magistrates' Court held that the case was suitable for trial before the Crown Court, and proceedings were adjourned.

[www.fsa.gov.uk/pages/Library/Communication/PR/2009/002.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/002.shtml)

## **FSA Reduces Rights Issue Subscription Periods**

On 12 January, the FSA proposed the reduction of the minimum subscription period for companies undertaking a rights issue from 21 calendar days to either 14 calendar days or 10 business days. The FSA stated that this measure could help make equity raising more efficient and orderly.

The proposals implement recommendations made in the November 2008 Rights Issue Review Group report to the Chancellor of the Exchequer.

The consultation closed on 26 January, and the FSA introduced the changes in early February.

[www.fsa.gov.uk/pubs/cp/cp09\\_04.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_04.pdf)

## **Immunity Powers Proposed for the FSA**

On 14 January, the UK government announced proposals that would give the FSA new statutory powers. The FSA will be categorised as a "specified prosecutor" under the UK Serious Organised Crime and Police Act 2005 and will be given power to grant immunity when it investigates criminal cases such as insider dealing. The proposed change is to be made by a provision in the Coroners and Justice Bill currently before parliament.

[www.publications.parliament.uk/pa/cm200809/cmbills/009/2009009.pdf](http://www.publications.parliament.uk/pa/cm200809/cmbills/009/2009009.pdf)

## **Further Fine for Monterrico Metals Market Abuse**

In the January 2009 edition of *London Update* we reported the FSA's imposition of fines on Filip Boyen and Richard Ralph for dealing in the shares of Monterrico Metals Plc (Monterrico), an AIM-quoted company, on the basis of inside information. On 14 January, the FSA fined Erik Boyen, the brother of Filip Boyen, £49,000 in addition to requiring a disgorgement of profits of £127,254.85.

Richard Ralph, then the executive chairman of Monterrico, was involved in confidential discussions related to a proposed takeover. Before any information became public, he asked Filip Boyen to buy Monterrico shares on his behalf. Filip Boyen then asked his brother Erik Boyen to buy shares on his behalf. Filip Boyen thereby passed on inside information. Erik Boyen was aware that the company was in takeover discussions and knew that Mr. Ralph was a Monterrico insider and had asked his brother to buy shares in the company. Erik Boyen also encouraged a third party to deal in Monterrico shares.

Erik Boyen settled at an early stage of the investigation and qualified for a 30% discount on the fine element of the penalty.

[www.fsa.gov.uk/pubs/final/erik\\_boyen.pdf](http://www.fsa.gov.uk/pubs/final/erik_boyen.pdf)

## **Wolfson Microelectronics Fined for Disclosure Delay**

On 20 January, the FSA fined Wolfson Microelectronics plc (Wolfson) £140,000 for failing to reveal price-sensitive information to the market in a timely manner, leading to the creation of a false market in Wolfson shares for 16 days in March 2008.

On 10 March 2008, Wolfson was informed by Apple Computer, one of its major customers, that Apple would not be using Wolfson as a supplier of chips for its iPod MP3 player. It was estimated that this would represent a loss of \$20 million or 8% of Wolfson's 2008 forecast revenue. At the same time, Apple also awarded Wolfson a contract to supply parts for the iPhone that should offset much of the loss from the iPod contract.

Wolfson discussed the matter on 12 March with its investor relations advisors, who recommended that there was no need to disclose the negative news, and Wolfson delayed making an announcement on the basis of that advice.

Wolfson reconsidered the earlier advice and eventually sought advice from its lawyers and corporate stockbrokers, contacting them on 20 March just before the Easter holiday. In a conference call on 25 March after the Easter holiday, Wolfson's lawyers recommended disclosure. Wolfson disclosed the news early on the morning of 27 March, and its share price went down roughly 18%.

The FSA considered that Wolfson's reliance on their investor relations advisors was insufficient. The breach of the disclosure obligation was quite clear. Their position might have been improved if they had consulted their lawyers earlier. The FSA stated: "Companies have the primary responsibility for meeting their disclosure obligations. While they may benefit from seeking advice from those in a position to comment on their regulatory requirements, they cannot rely, without due consideration, on such advice." The FSA emphasised that its position (set out in publications and previous enforcement cases) was that it was not acceptable to justify non-disclosure of information by offsetting negative and positive news. Companies must disclose both types of information and allow the market to determine whether they cancel each other out.

Since Wolfson had co-operated with the FSA's investigation, it received a 30% discount of the £200,000 fine for early settlement.

[www.fsa.gov.uk/pubs/final/Wolfson\\_20jan09.pdf](http://www.fsa.gov.uk/pubs/final/Wolfson_20jan09.pdf)

## **FSA Publishes Results of MiFID Thematic Review**

On 21 January, the FSA published the results of its thematic review of the implementation of a number of key "wholesale" requirements of the EU Markets in Financial Instruments Directive (MiFID). MiFID introduced certain new, more extensive requirements for FSA authorised firms, including new conduct of business and organisational requirements.

In September 2007, the FSA identified wholesale and retail business areas of MiFID that were a priority for its review. The wholesale priorities included: (i) best execution; (ii) inducements; (iii) investment research; (iv) client classification; (v) conflicts of interest; and (vi) senior management systems and controls. The thematic review was undertaken between June and November 2008 and included 43 wholesale firms.

[www.fsa.gov.uk/pubs/international/mifid\\_sup\\_priorities.pdf](http://www.fsa.gov.uk/pubs/international/mifid_sup_priorities.pdf)

## **Chairman of the FSA Sets Out Regulatory Reform Agenda**

On 21 January, Lord Adair Turner, chairman of the FSA, gave The Economist's Inaugural City Lecture in London. He set out his views on the root causes of the global financial crisis and on the implications for future regulation of the financial system.

Lord Turner said he believed the "originate and distribute" model of financing lending had a role to play in the future, but needed to be reformed, with less complexity and opacity. He also said that over the last decade the scale of proprietary

trading has created risks and that financial innovation has, in many cases, delivered minimal economic value and actually increased the dangers of financial instability.

In his lecture, Lord Turner outlined three key long-term regulatory initiatives to reduce the probability and severity of future financial crises: (i) the introduction of new capital adequacy approaches including counter-cyclical capital requirements and requiring more capital to be held against risky trading strategies; (ii) creating a new liquidity regime focused on market-wide risk as well as individual firms' liquidity; and (iii) ensuring that financial activity is regulated according to its economic substance, not its legal form.

These themes will be developed further in the "Turner Report" on the regulation and supervision of the banking system, which will be published in March 2009.

[www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0121\\_at.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0121_at.shtml)

## **Entertainment Rights plc Fined for Disclosure Delays**

On 23 January, the FSA fined Entertainment Rights plc (ERT) £245,000 for failing to disclose inside information to the market in a timely manner.

As a result of the variation of a DVD distribution agreement on 10 July 2008, which variation significantly amended the terms of the distribution agreement, the company's estimated 2008 profits were reduced by £9.7 million. ERT delayed making an announcement, as it considered that there would be future opportunities to reduce the impact of the variation. ERT finally made an announcement of the variation 78 days later, on 26 September, and its shares fell 55% on that day.

The FSA found that the variation was inside information and the lack of timely disclosure led to a false market in ERT's shares for the 78 days in which disclosure was delayed. As in Wolfson Microelectronics plc, discussed above, the FSA emphasised that justifying non-disclosure of information by offsetting negative and positive news is not acceptable. Companies should disclose both types of information and allow the market to determine whether they cancel each other out.

The FSA took into account that ERT fully co-operated with the FSA investigation and has since taken steps to strengthen its board. ERT also qualified for a 30% discount under the FSA early settlement discount scheme, without which the fine would have been £350,000.

[www.fsa.gov.uk/pubs/final/ent\\_rights19jan09.pdf](http://www.fsa.gov.uk/pubs/final/ent_rights19jan09.pdf)

## **FSA Consults on Use of Firm-Commissioned Reports**

On 26 January, the FSA published consultation paper *CP09/05 Obtaining and using firm-commissioned reports*, setting out proposed guidance on the FSA's approach to using firm-commissioned reports in anticipation of a possible FSA enforcement action.

The FSA stated that it understands that when it investigates firms, the firms in question often decide to commission internal reports from law or accountancy firms, and firms often discuss the scope of their investigation with the FSA and agree to provide a copy of the final report. The FSA considers that several common issues have arisen, including whether firms must disclose internal reports and the waiver of privilege in the context of FSA investigations. The FSA therefore considers that it would be helpful to clarify its expectations in relation to reports which firms commission from their legal or other advisors.

The consultation closed on 23 February.

[www.fsa.gov.uk/pubs/cp/cp09\\_05.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_05.pdf)

## **FSA Bans Former Executives of Pacific Continental Securities UK Limited**

On 28 January, the FSA banned the former chief executive of stockbroker Pacific Continental Securities UK Limited (PCS), Steven Griggs, and its former finance director, Charles Weston. They were also fined £80,000 and £95,000, respectively, for serious failures in the company that led to customers buying high-risk shares without suitable advice. The former CEO was banned from carrying out any significant influence functions at an FSA authorised firm, and the former finance director was banned from carrying out any regulated activities.

PCS is now in liquidation. The FSA stated that if that had not been the case it would have been fined £2 million. The FSA censured PCS for misleading customers and allowing its advisors to use inappropriate sales practices when giving advice on high-risk shares.

The FSA found that between 1 April 2005 and 20 June 2007, Griggs and Weston had acted without integrity and had failed to ensure that their customers were treated fairly or that the company was properly run. Particularly, PCS was using high-pressure sales tactics and was recommending shares to benefit PCS, not its customers. In addition, the FSA found that PCS research was not honest and realistic and that there were inadequate compliance monitoring and training arrangements at the company.

[www.fsa.gov.uk/pubs/final/steven\\_griggs.pdf](http://www.fsa.gov.uk/pubs/final/steven_griggs.pdf)

[www.fsa.gov.uk/pubs/final/charles\\_weston.pdf](http://www.fsa.gov.uk/pubs/final/charles_weston.pdf)

[www.fsa.gov.uk/pubs/final/pacific\\_continental.pdf](http://www.fsa.gov.uk/pubs/final/pacific_continental.pdf)

## **FSA Consults on Short Selling Regime Changes**

On 6 February, the FSA issued a discussion paper (DP09/1 *Short Selling*) in which it proposed broadening the current disclosure requirement with respect to significant net short positions in financial stocks to apply to all UK-listed equities. The proposed threshold is 0.50% for initial disclosure and for subsequent changes of 0.1% or more, compared with the current requirement for disclosure of 0.25% in relation to UK financial sector equities.

In June 2008, the FSA introduced a disclosure requirement with respect to issuers undertaking rights issues, as reported in the July 2008 edition of [London Update](#). The FSA then introduced a four-month temporary ban on establishing or increasing net short positions in UK financial stocks on 18 September, as reported in the November 2008 edition of [London Update](#). The ban was combined with a requirement for the disclosure of existing net short positions in financial stocks exceeding 0.25% of an issuer's share capital. As reported above, on the expiration of the ban on 16 January 2009, it was not renewed, but the requirement for the disclosure of net short positions was extended until 30 June 2009. At that time the FSA announced that it would consult on proposals for a long-term regime, and DP09/1 is the result.

The consultation period lasts until 8 May, following which permanent rules will be announced.

[http://www.fsa.gov.uk/pubs/discussion/dp09\\_01.pdf](http://www.fsa.gov.uk/pubs/discussion/dp09_01.pdf)

## **FSA Publishes Market Watch 31**

On 26 February, the FSA published issue 31 of its *Market Watch* newsletter. This issue of *Market Watch* focuses on transaction reporting. In particular, the FSA emphasised that regulated firms must have in place appropriate systems and controls covering all aspects of transaction reporting, since the FSA's ability to identify and investigate possible market abuse depends on it receiving complete and accurate transaction reports from firms. The FSA drew attention to its Transaction Reporting User Pack, which summarises how transaction reports should be completed, and issue 29 of *Market Watch*, which includes transaction reporting information to be considered by firms when assessing their system and controls.

[http://www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter31.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter31.pdf)

# **EU Developments**

## **European Commission Launches Review of the EU Prospectus Directive**

On 9 January, the European Commission launched a consultation on the application of the EU Prospectus Directive (2003/71/EC). Following discussions with the Committee of European Securities Regulators and the European Securities Markets Expert Group, the Commission considers that some aspects of the Prospectus Directive (which has been in force since July 2005) now merit a review and has put forward proposals in the consultation to improve and simplify the Directive.

The Prospectus Directive introduced a "single passport for issuers", making securities available to investors either through a public offer procedure or by admitting their shares to trading. Once approved by the regulatory authority of one EU Member State, a prospectus must be accepted in any other EU Member State. The Directive aims to ensure that investors are provided with clear and comprehensive information when making investment decisions.

In particular, the Commission suggests measures to address: (i) definition of qualified investors; (ii) revision of exempt offers; (iii) revision of annual disclosure obligation; (iv) time limit for exercise of right of withdrawal; and (v) certain thresholds of the Prospectus Directive.

The consultation also considers issues that have been brought to the Commission's attention such as the effectiveness of the prospectus summary, disclosure requirements for government guaranteed offers and disclosure requirements for small quoted companies and rights issues.

The consultation closed on 10 March.

[www.ec.europa.eu/internal\\_market/consultations/docs/2009/prospectus/background\\_en.pdf](http://www.ec.europa.eu/internal_market/consultations/docs/2009/prospectus/background_en.pdf)

## European Leaders Advocate Enhanced Regulation

A group of European heads of government and finance ministers held a summit in Berlin on 22 February ahead of the Group of 20 summit scheduled to take place in London on 2 April. Representatives of the European Commission and eight leading European financial centers including Germany, France and the UK agreed on seven key points. They issued a joint statement in which they endorsed a plan to create a comprehensive international regulatory framework. Although the details remain to be worked out, the statement endorsed a plan to create a regulatory framework covering "all financial markets, products and participants—including hedge funds and other private pools of capital which may pose a systemic risk."

The joint statement continued: "Private investment companies, including hedge funds, should also be subjected to international control. If left uncontrolled they can always become a threat to the stability of the global financial system." The European leaders added that rating agencies should also be "registered and monitored" in light of the influence they exercised and recommended the imposition of sanctions on tax havens and other countries allowing non-transparent and improper business transactions.

[http://www.bundestkanzlerin.de/nn\\_127694/Content/EN/Artikel/2009/02/2009-02-22-g20-eu-vorbereitungsgipfel\\_en.html](http://www.bundestkanzlerin.de/nn_127694/Content/EN/Artikel/2009/02/2009-02-22-g20-eu-vorbereitungsgipfel_en.html)

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