London Update

UK Financial Services Regulatory Developments

Katten

Katten Muchin Rosenman Cornish LLP

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This edition covers UK and EU developments between 1 February and 28 February 2010.

UK DEVELOPMENTS

SEC and FSA Announce Results of Strategic Dialogue Meeting

On 1 February, the Financial Services Authority (FSA) and the Securities and Exchange Commission (SEC) announced the results of a meeting held between Lord Turner and Hector Sants, Chairman and Chief Executive of the FSA respectively, and Mary Schapiro, SEC Chairman.

The announcement disclosed that the UK and US regulators discussed, among other matters: corporate governance and executive compensation; regulation of hedge funds and investment advisers and the protection of customer assets; disclosure regimes around client asset risks; market infrastructure, particularly relating to central counterparties for OTC derivatives; market supervision; and cooperation on cross-border supervision.

The regulators agreed that enhanced supervisory cooperation was crucial to market integrity. In order to facilitate expanding cooperation in areas such as oversight of credit rating agencies, hedge fund advisors and the clearing of OTC derivatives, they agreed to undertake a review of the current 2006 Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Financial Services Firms and Market Oversight.

According to FSA Chief Executive Hector Sants, "Global cooperation between regulators is central to tackling the reform agenda, and the relationship between the FSA and the SEC is key for international markets." SEC Chairman Schapiro said, "This dialogue has proved its utility again in allowing the SEC and FSA to share expertise and experiences regarding the rapid changes occurring in our capital markets."

Read more.

London Hedge Fund Manager Banned for Mismarking

On 3 February, the FSA announced that it had banned Simon Treacher, a London-based hedge fund manager, and fined him £140,000 for deceiving investors by mismarking funds he managed and misleading the FSA during its investigation.

Simon Treacher was an FSA approved person employed by BlueBay Asset Management plc as a senior fund manager in Blue Bay's emerging markets team. For a period of several months in 2008, he physically cut out and pasted different figures on to hard copies of documents used in the valuation process of assets of the funds he managed. Mr. Treacher then provided misleading information about his conduct to the FSA during its investigation.

The fraudulent alterations led to an apparent increase of approximately $27 million in the value of the funds in question. This resulted in investors being financially disadvantaged by approximately $650,000. The FSA stated that BlueBay had fully compensated the investors and that it made no criticism of BlueBay in connection with this investigation.

Mr. Treacher agreed to settle at an early stage of the FSA's investigation, thereby qualifying for a 30% reduction in the fine which would otherwise have been £200,000.

Read more.

FSA Fines Oil Company Executives for Market Abuse

On 16 February, the FSA published the final notices it had issued to three executives of Genel Enerji A.S., a Turkish oil exploration company, after finding all three men (Mehmet Sepil, Murat Ozgul and Levent Akca) had engaged in market abuse relating to dealing in the shares of Heritage Oil Plc, a UK listed company.

The fine imposed on Mr. Sepil, Genel's chief executive officer, was £967,005, the largest market abuse fine by the FSA against an individual. The FSA fined Mr. Ozgul, Genel's chief commercial officer, and Mr. Akca, its exploration manager, £105,240 and £94,062, respectively. The fines reflected a 30% discount for settlement at an early stage of the FSA's investigation. Each fine included a sum representing disgorgement of profits: respectively £267,005, £35,240 and £10,062.

In March 2009, Genel entered into a joint venture with Heritage regarding the exploration of the Miran oil field in Northern Iraq. On 4 May, all three executives flew to London and discussed the positive test results which had been received from the oil field. The following day they all purchased Heritage shares.

On 6 May, Heritage announced the results of the drilling tests at Miran and its share price increased by approximately 25%. On the same day, the three Genel executives sold their Heritage shares.

In each case, the FSA final notices state that the level of the penalty reflects the fact that the three men voluntarily contacted the FSA, expressed remorse, made admissions as to their conduct and cooperated in the FSA's investigation. The final notices also contain findings that the men did not set out to commit market abuse, were not familiar with the legal requirements which prohibited them from dealing in Heritage shares, and had not received legal advice at the time. Nonetheless, the FSA concluded that they were serious examples of insider dealing by persons in positions of responsibility, and in determining the appropriate level of the fine, the FSA considered, among other things, the need to punish them appropriately to deter others in similar positions from committing market abuse.

Click here to read the final notice for Mehmet Sepil.
Click here to read the final notice for Murat Ozgul.
Click here to read the final notice for Levent Akca.

Firm Fined for Completing Acquisition without FSA Approval

On 17 February, the FSA announced that at the City of Westminster Magistrates Court, Semperian PPP Investment Partners Limited Partnership had pleaded guilty to acquiring an authorised firm before it had received the necessary FSA approval, an offense under Section 191(3) of the Financial Services and Markets Act 2000. Semperian notified the FSA in mid-December 2008 that it proposed to acquire the firm in question but completed the purchase three weeks later, before FSA approval had been obtained.

The court imposed a fine of £1,000, stating that Semperian had taken a calculated risk that the FSA would not prosecute. In determining the level of the penalty, the court noted that the maximum fine at the date of the offense was £5,000 (the penalty has since been increased to an unlimited fine), the fact that Semperian had pleaded guilty at the earliest opportunity and that there had been no adverse impact upon consumers.

For more details click here.

FSA Hedge Fund Surveys Conclusions Published

On 23 February, the FSA published a report entitled "Assessing possible sources of systemic risk from hedge funds." The report sets out the FSA's key findings and conclusions from two surveys it conducted in October 2009—the Hedge Funds as Counterparties Survey (HFACS) and the Hedge Fund Survey (HFS). The FSA intends to continue conducting these surveys every six months to help monitor trends in hedge funds.

The HFACS has been conducted every six months since 2005. It asks some of the largest FSA-authorised banks with exposures to hedge funds about their credit counterparty risks.

The HFS was introduced in October 2009 to complement the HFACS. It surveyed the 50 largest FSA-authorised investment managers representing about 20% of the global industry. The survey asks questions about the assets the firms managed and the larger funds for which they undertake management activities.

The report's conclusions were that: "The HFACS data suggests that on 31 October 2009 major hedge funds did not pose a potentially destabilising credit counterparty risk across the surveyed banks. HFS data shows a relatively low level of 'leverage' under our various measures and suggests a contained level of risk from hedge funds at that time."

The FSA stated that it hoped that its "work in this area can contribute to the ongoing debate about" the proposed EU Alternative Investment Fund Managers Directive (AIFMD). The clear message sent by the FSA in making this statement is that the survey results, which indicate the low systemic risk posed by the hedge fund sector, should be preferred to the preconceptions of some of the politicians and others promoting aspects of the AIFMD proposals.

To read the report in full, click here.

FSA Fines Financial Advice Firm £700,000 for Failings Relating to Lehman-Backed Structured Product Sales

On 25 February, the FSA published the Final Notice it has issued to RSM Tenon Financial Services (Tenon), fining it £700,000 for significant failings in its advice and sales processes relating to Lehman-backed structured products and for having poor systems and controls to prevent unsuitable advice in its structured product and pension switching business. The fine was discounted by 30% because Tenon cooperated fully with the FSA and agreed to settle at an early stage in the investigation. Without the discount, the fine would have been £1,000,000.

The FSA concluded that, in relation to its sales of Lehman-backed structured products, Tenon failed to treat some of its customers fairly. Tenon had breached two of the FSA's Principles for Businesses by failing to take reasonable care to organise and control its affairs responsibly and effectively and by failing to take reasonable care to ensure the suitability of its advice to its customers. In addition, in relation to Tenon's structured products and pension switching business more generally, the FSA found that the firm failed to have effective risk management systems in place to manage and control its affairs, and it ultimately failed to minimise or prevent the risk of unsuitable sales.

In addition to the fine, the FSA has required Tenon to:

- Conduct a past business review of all sales of Lehman-backed structured products. Customers who received unsuitable advice will be able to sell their investment back to Tenon and to receive reimbursement of their money invested plus interest.
- Review sales of other structured products between November 2007 and December 2009 and pay appropriate redress where unsuitable advice was given.
- Conduct a review of pension switching business it transacted between April 2006 and December 2009 to assess the suitability of recommendations made to customers and, if appropriate, implement a customer redress program.
- Commission a "skilled person review" of its current sales and compliance processes to assess their appropriateness and the suitability of recommendations made to customers.

The FSA will oversee the business reviews and the redress process that it has ordered, and an independent third party will also review the work undertaken by Tenon.

This is the first enforcement action resulting from the FSA's review of the marketing and distribution of structured products, particularly those backed by Lehman Brothers entities, which was concluded in October 2009.

To read the Final Notice in full, click here.

EU DEVELOPMENTS

CESR Publishes Proposals to Extend Disclosure of Major Shareholding Regime

On 9 February, the Committee of European Securities Regulators (CESR) published its proposals for extending the disclosure of major shareholdings regime under the European Transparency Directive.

The current regime requires investors to make disclosures of holdings of voting rights attached to shares and voting rights an investor is entitled to acquire when certain thresholds are crossed. There is no current disclosure requirement for instruments with a similar economic effect, such as cash settled contracts for difference. The UK and some other countries address this in national legislation.

CESR has recognised that instruments of this kind could be used to acquire or exercise influence in a company, and in its proposals it cites a number of examples of where this has happened. To ensure greater transparency in situations such as these, CESR is proposing that the regime for notification of major shareholding should be extended to include all instruments that give a similar economic effect to holding shares and entitlements to acquire shares in the broadest sense. In CESR's opinion this approach balances the need for legal certainty with the potential for avoidance.

CESR notes that, where appropriate, its proposals are consistent with its approach to the European short selling regime. However, it makes it clear that CESR considers these are two separate regimes and serve different purposes.

In its proposals, CESR also makes it clear that these instruments are an important source of liquidity to the market and that it is not seeking to discourage their use but only to make their resulting economic exposure transparent.

To read the proposals in full, click here.

For more information, contact:

	Direct Dial	Email
Martin Cornish	+44 (0) 20 7776 7622	martin.cornish@kattenlaw.co.uk
Edward Black	+44 (0) 20 7776 7624	edward.black@kattenlaw.co.uk

Katten

Katten Muchin Rosenman Cornish LLP

www.kattenlaw.co.uk

1-3 Frederick's Place • Old Jewry • London EC2R 8AE
+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

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The Members of Katten Muchin Rosenman Cornish LLP (who for convenience only refer to themselves as Partners) are: Martin Cornish, Jack Governale (US lawyer), Arthur W. Hahn (US lawyer), Daniel Huffenus (US lawyer), Sloan Kelly, Andrew MacLaren, Imran Sami and Andrew Turner.

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