



London Update

UK Financial Services Regulatory Developments

November 2007

This edition of London Update covers UK and EU developments from September 28 through October 31.

UK Developments

FSA Publishes Paper on Good and Poor Practices in Key Features Documents

On September 28, the Financial Services Authority (FSA) published a paper on good and poor industry practices in the preparation of Key Features Documents (KFDs). After reviewing over 200 KFDs from a variety of UK firms, the FSA found that only 15 per cent of the sample met the FSA's requirements to ensure that information is communicated to clients in way that is clear, fair and not misleading.

The FSA's main areas of concern included: explanations of risk, product charges, general product information and their objectives. Firms are now expected to review their KFDs by December 2008 and to make any necessary changes. The FSA will consider enforcement action where appropriate and intends to sample a sub-set of these KFDs again in November 2008 and to repeat the full review in 2010.

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

LSE Makes Final MiFID Handbook Changes

On October 4, the London Stock Exchange (LSE) confirmed detailed changes to its dealing rules in preparation for the November 1 implementation of the EU Markets and Financial Instruments Directive (MiFID).

The key changes include: (i) clarification of the requirements for the reporting of client-side legs of risk-less principal transactions, (ii) the use of negotiated and large trade waivers, (iii) the LSE's deferred publication regime, (iv) European Trade Reporting, (v) the removal of rules relating to the Traditional Options Market, and (vi) clarifications on the use of the terms "customer" and "counterparty".

www.londonstockexchange.com/NR/rdonlyres/224320A5-3B7D-411E-B768-7A2F6045CBBF/o/N6707.pdf

FSA Publishes 3Q 2007 Quarterly Consultation

On October 5, the FSA published its latest quarterly consultation paper, which sets out proposals to amend various sections of its handbook, including:

- Amendments to the FSA's Collective Investment Schemes handbook that include changes as a result of the EU Eligible Assets Directive clarifying the types of instruments and techniques that may be eligible for use in Undertakings for Collective Investment in Transferable Securities (UCITS) funds, such as transferable securities, money market instruments, derivatives, efficient portfolio management, indices and other collective investment schemes.
- Amendments to the General Prudential sourcebook to allow substitution into directly issued preferential non-cumulative preference shares with a step-up as well as directly issued non-innovative tier one capital instruments and clarifications on the rules for coupon payments.
- Various amendments and clarifications in respect of the mortgage and insurance business, including the treatment of lifetime mortgages for the calculation of capital adequacy requirements, the use of intermediaries for mortgage and home finance firms, and the FSA's permitted links rules.
- Consequential amendments as a result of the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007 which came into effect on July 12, as described in the July 20, 2007 edition of Katten's *Corporate and Financial Weekly Digest*.

The deadline for comments on the proposals is December 5.

www.fsa.gov.uk/pubs/cp/cp07_18.pdf

UK Chancellor Announces Amendments to Investment Management Exemption

On October 9, the UK Chancellor of the Exchequer, Alistair Darling, announced changes to the Investment Management Exemption (IME) in his Pre-Budget Report to the House of Commons. These changes complement the HM Revenue & Customs' revised Statement of Practice on the IME published in July 2007, as described in the July 27, 2007 edition of *Corporate and Financial Weekly Digest*. They are seen as a helpful simplification of the IME regime.

The changes include: (i) broadly aligning the list of transactions to those transactions and activities that are regulated by the FSA in order to clarify the scope of "investment transactions", and (ii) providing for a more proportionate tax effect on non-qualifying transactions, and will be enacted in the Finance Bill 2008.

www.hmrc.gov.uk/pbr2007/pbrn7.pdf

UK Treasury Publishes Discussion Paper on Offshore Funds

On October 9, the UK Treasury published a discussion paper setting out its plans to modernize the UK tax regime for offshore funds and strengthen existing UK anti-avoidance rules. The proposals introduce a new framework for offshore funds and the tax treatment of UK investors based on funds being classified as "Reporting Funds" rather than "Distributing Funds" as they are currently termed. The proposals include: (i) changing the definition of offshore funds so as to be based on the characteristics of the fund, (ii) enabling funds to apply in advance for treatment as "Reporting Funds" instead of the current regime where an application to be a "Distributing Fund" must be made at the end of each year, and (iii) the removal of percentage investment restrictions and limits on the number of layers into which a "Reporting Fund" may invest.

The deadline for comments is January 9, 2008.

www.hm-treasury.gov.uk/media/2/E/pbr_csro7_offshore402.pdf

UK Hedge Fund Working Group Publishes Proposals for Voluntary Code

On October 11, the UK Hedge Fund Working Group announced a consultation on its proposals for a voluntary code for the UK hedge fund industry. The proposals include improved transparency in respect of risk, asset valuations and trading strategies.

The proposed code also asks hedge fund managers to stress-test their holdings and to provide information on risk controls to investors and lenders.

The Working Group was established in June by 14 hedge funds, as described in the June 22, 2007 edition of *Corporate and Financial Weekly Digest*, and is chaired by Sir Andrew Large. Sir Andrew is a former Deputy Governor of the Bank of England (2002-2006) and former Chairman (1992-1997) of the precursor of the FSA, the Securities and Investments Board.

The deadline for responses is December 14.

www.hfwg.co.uk/?section=10365

UK Government Publishes Discussion Paper on Depositor Protection

On October 11, the UK Treasury, the FSA and the Bank of England published a joint discussion paper on depositor protection and proposed improvements to the framework for dealing with banks in financial difficulties.

The paper seeks comments on proposed reforms to the current depositor compensation system and approaches that the UK Government should take to preserve key UK banking functions where there is a risk of a bank failure.

The deadline for comments on the paper is December 5.

www.hm-treasury.gov.uk/media/6/3/consult_bankingreform11007.pdf

High Court Rules on Effect of Non-Reliance Clause

On October 12, in a case in which there was a clear statement in a brochure which was contradicted by the terms of the relevant contract, the High Court declined to enforce a non-reliance clause in the contract. The High Court held that a party which engaged in misrepresentation would only be protected by a non-reliance clause in a subsequent written agreement if it could demonstrate that it believed the other party had not relied on any representations outside the written agreement.

The Court stated that non-reliance clauses will be construed in the context of the whole transaction and will not automatically protect parties from misrepresentations they might have made earlier in the transaction.

www.bailii.org/ew/cases/EWHC/QB/2007/2313.html

FSA Publishes Feedback on Financial Promotion Rules

On October 15, the FSA published answers to commonly asked questions it has received relating to its new rules on client communications and financial promotions. The rules came into effect on November 1 and form Chapter 4 of the FSA's new Conduct of Business Sourcebook (COBS).

www.fsa.gov.uk/pages/Doing/Regulated/newcob/comms2.shtml

Administrative Receivers Obtain Ruling to Stop SIV Debt Payments

On October 18, the High Court, in a sealed judgment in a case brought by the administrative receivers of a structured investment vehicle (SIV), allowed the SIV to be declared insolvent based on a balance sheet test. The administrative receivers of the SIV applied to the Court on the basis that the SIV was insolvent using the balance sheet test for insolvency despite reports that it still had \$1.3 billion in cash. The Court's decision will allow the receivers to stop paying the SIV's short-term debt.

A company is insolvent under the balance sheet test if there is a shortfall in the value of its assets in relation to the amount of its liabilities, including both contingent and prospective liabilities.

investing.reuters.co.uk/news/articleinvesting.aspx?type=breakingFundsNews&storyID=2007-10-18T073327Z_01_L18631453_RTRIDST_o_CHEYNE-SIV.XML

LSE Censures and Fines AIM Nomad

On October 19, the LSE announced that Nabbarro Wells & Co Limited, a nominated adviser ("nomad") of the UK's Alternative Investment Market (AIM), had been fined £250,000 and publicly censured for breaches of Rule 39 of the AIM Rules and Part 2 of the AIM Nominated Adviser Eligibility Criteria.

Observing that it delegates to nomads certain important regulatory responsibilities, such as that of assessing the appropriateness of companies for AIM and stating that nomads fulfill a vital role in maintaining the quality of companies, the LSE imposed sanctions on Nabbarro Wells for its: (i) insufficient systems and controls, (ii) failure to act with due skill and care, (iii) failure to undertake the necessary level of due diligence to assess the appropriateness of certain companies for admission to trading on AIM, and (iv) failure to make due and careful enquiry into whether certain companies' AIM admission documents complied with AIM rules.

www.londonstockexchange.com/NR/rdonlyres/B037D460-B3C5-42E6-8BCB-E08D34131B40/o/AD1v4clean.pdf

FSA Publishes Financial Crime Newsletter

On October 23, the FSA published its ninth Financial Crime Newsletter, which gave updates on the FSA's work on issues including: identity theft prevention, information security for appointed representatives, property fraud, illegal "boiler rooms" (drawing attention to the fact that it has recently acted to close down two boiler rooms), and changes to the UK's financial sanctions procedures.

www.fsa.gov.uk/pubs/newsletters/fc_newsletter9.pdf

FSA Publishes Feedback on Operational Risk Management

On October 30, the FSA published feedback from a thematic review of operational risk management practices carried out during the second half of 2006 and the first quarter of 2007.

The FSA intends that this feedback will assist firms in establishing operational risk management procedures that comply with the FSA's new operational risk rules, which will be effective from January 1, 2008.

The FSA observed that almost all firms now had a dedicated operational risk function. Generally firms of all sizes have a much more mature operational risk framework than they had in 2005. There has been good practice in several firms, with some of the medium-size firms lagging behind the smaller ones. Some that said they intend to implement The Standardised Approach (TSA) clearly had much work to do, mostly in three areas:

- better analysis and reporting of the information they were collecting;
- providing appropriate training; and

- embedding operational risk policies and their chosen methodology.

www.fsa.gov.uk/pubs/international/or_practices_oct07.pdf

UK Credit Card Companies' Liability Extended

In a case decided on October 31, the House of Lords confirmed consumers' rights against UK credit card companies for purchases made from non-UK retailers.

Under section 75(1) of the Consumer Credit Act 1974, a creditor such as a credit card company is jointly and severally liable with the supplier in respect of any misrepresentation or breach of contract by the supplier in relation to a transaction financed by the creditor. The House of Lords confirmed that the right of consumers to hold UK credit card companies liable for a breach of contract by retailers from whom they have made a credit card purchase extends to transactions with overseas retailers. The only limitation on the territorial scope of section 75(1) is that the credit agreement must be a UK credit agreement.

www.publications.parliament.uk/pa/ld200607/ldjudgmt/jdo71031/lloyds-1.htm

EU Developments

FIA and FOA Sign Cooperation Agreement

On September 28, the US Futures Industry Association (FIA) and the European Futures and Options Association (FOA) announced that they have signed a cooperation agreement under which they will work more closely together.

The new structure is expected to (i) facilitate communication, (ii) avoid the duplication of effort, (iii) establish a single industry voice in Europe, and (iv) promote a unified view on issues that impact global intermediaries.

The FIA and FOA will continue to work together in organizing the associations' joint annual conference and trade fair, and in organizing educational workshops.

www.foa.co.uk/external/releases/fia_foa_announcement_sep07.pdf

CEBS Consults on Commodities Risks

On October 10, the Committee of European Banking Supervisors (CEBS) published its report on prudential risks that may arise from the conduct of commodities business and the activities of firms carrying out commodities business.

CEBS concludes that the risks present in commodities business are broadly in line with the risks present in other financial markets, and that they are generally the same across all types of underlying assets. As the majority of transactions are carried out OTC, significant risks still remain in commodities business and those risks need to be appropriately managed. The report highlights that interconnections between firms carrying on commodities business have increased the perception of systemic risk. The exact extent of any systemic risk will depend on the size of the respective markets for commodities relative to the wider financial market and may vary widely across different markets.

www.c-ebs.org/Advice/advice.htm

CESR Launches Consultation on UCITS Investor Disclosures

On October 16, the European Committee of European Securities Regulators (CESR) published a consultation paper on the content and form of Key Investor Information (KII) disclosures for retail-orientated UCITS funds.

The consultation was launched at the request of the EU's European Commission. The Commission asked CESR to provide advice on the form and contents of KII, which it proposes to introduce as a replacement for the simplified prospectus currently used with UCITS funds.

It is CESR's view that KII should contain only the essential elements for assisting retail investors in making and carrying out informed investment decisions. In this context, CESR has considered factors likely to make product information disclosures useful to retail investors. The consultation sets out CESR's recommendations on the scope, format and content of KII, the use of past performance information, and on charges.

The consultation closes on December 17 and CESR plans to provide its initial advice to the Commission in February 2008.

www.cesr-eu.org/popup2.php?id=4814

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Upcoming Breakfast Seminar:

Capital Requirements for Hedge Fund Managers and Broker Dealers

Date: Tuesday 20 November 2007

Venue: London Capital Club, London EC4

For an invitation, please contact terri.duggan@kattenlaw.co.uk

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