



London Update

UK Financial Services Regulatory Developments

November 2008

This London Update covers the period from 30 August to 31 October 2008

UK Developments

FSA Sanctions Hedge Fund Manager for Market Abuse

On September 8, the Financial Services Authority (FSA) announced that it had reached a settlement with Steven Harrison, a former hedge fund manager, regarding an enforcement action against Mr. Harrison for market abuse.

The action concerned Mr. Harrison's conduct on September 28, 2006 while a portfolio manager for Moore Credit Fund. He received inside information about the refinancing plans of Rhodia SA (Rhodia) and upon receipt of the information, instructed a colleague to buy 2 million Rhodia 10.50% Senior Notes due 2010. He made a profit of £44,000 on that trade.

The FSA found that Mr. Harrison's conduct was not deliberate and that he made no direct personal profit from these activities. Since he co-operated with the FSA's investigation he qualified for an early settlement discount on his fine, which otherwise would have been £75,000. The FSA stated that the very significant impact of the 12-month restrictions to which Mr. Harrison has agreed was taken into account in setting the penalty.

The FSA stated that this was the first case it has brought concerning the credit markets and that this sent a clear message that the FSA is determined to tackle market abuse in all the markets it regulates.

Margaret Cole, the FSA's Director of Enforcement, commented, "This case highlights the importance of city professionals taking care to recognise inside information when they see it and not to misuse it. Hedge fund managers and people in similar roles are often legitimately provided with inside information in the course of their business. The FSA expects people entrusted with such responsibility, in the credit markets as much as in any other regulated markets, to observe high standards of conduct and not to take advantage of their privileged access to inside information. The consequences for Mr. Harrison of not doing so are that he has lost the privileges of carrying on his profession as a fund manager and a trader for a period."

www.fsa.gov.uk/pubs/final/steven_harrison.pdf

Court Rules That FSA may Proceed With Insider Trading Cases

On September 19, the FSA was given permission to proceed with legal action in two insider trading cases. Judge Quentin Purdy of the City of Westminster Magistrates Court dismissed an application made on behalf of the defendants which argued that the FSA needed to seek the permission of either the UK Director of Public Prosecutions (DPP) or the UK Secretary of State before commencing insider trading prosecutions.

The Judge ruled that the FSA did not need the prior approval of the DPP or the Secretary of State. He said that it was plain that "the aim of Parliament in creating the FSA was to place it to the forefront in general regulation of fiscal markets, including, where necessary, criminal proceedings dealing with fiscal markets and their regulation."

www.business.timesonline.co.uk/tol/business/law/article4809805.ece

FSA Increases Deposit Protection

On October 3, the FSA increased the compensation limit for bank deposits from £35,000 to £50,000 and joint bank accounts will be eligible to claim up to £100,000. The increase took effect on Tuesday, October 7.

The FSA also published CP08/15 *Financial Services Compensation Scheme: Review of Limits* consultation paper on further reforms. The consultation considers whether the compensation limit should be raised further, how the UK Financial Services Compensation Scheme pays compensation, and the basis upon which bank deposits are covered. The consultation also sets out proposals to improve the overall scheme and to ensure consistency with respect to compensation limits for the investment, insurance and home finance sectors.

The consultation closes January 5, 2009.

www.fsa.gov.uk/pubs/cp/cpo8_15.pdf

UK Announces Financial Support to Banking Sector

On October 8, the UK Government announced that it is introducing additional measures to ensure the stability of the UK financial system and to protect savers, depositors, businesses and borrowers.

The proposals are intended to: provide sufficient liquidity in the short term, make available new capital to UK banks and building societies, and ensure that the UK banking system has the funds necessary to maintain lending in the medium term.

The Bank of England will extend its facilities to provide short-term liquidity and the Government has announced that at least £200 billion will be made available to banks under a Special Liquidity Scheme. The Bank of England will continue to conduct auctions to lend sterling for three months, and also U.S. dollars for one week, against extended collateral. Bank debt that is guaranteed under the Government's guarantee scheme will be eligible in all of the Bank of England's extended-collateral operations.

The Government is also establishing a facility which will make available capital in appropriate form (expected to be preference shares or Permanent Interest Bearing Shares) to "eligible institutions". Eligible institutions are UK incorporated banks (including UK subsidiaries of foreign institutions) which have a substantial business in the UK and building societies.

The Government has also announced that it will make available to eligible institutions for an interim period a Government guarantee of new short and medium term debt issues to assist in refinancing maturing, wholesale funding obligations as they fall due. The Government expects the take-up of the guarantee to be in the region of £250 billion.

www.publications.parliament.uk/pa/cm200708/cmbills/147/2008147.pdf

FSA Amends Short Selling Daily Disclosure Requirement

On October 22, the FSA announced that it had completed its 30-day review of the additional short selling provisions introduced to its Code of Market Conduct on September 18, 2008.

The FSA has decided to make only one change. It will amend the Code of Market Conduct so that once disclosure of a short position has been made, additional disclosures will only be required when that short position changes, not, as currently required, on a daily basis.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/122.shtml

FSA Gives Feedback on Disclosure of Contracts for Difference (CFDs)

On October 23, the FSA published a feedback statement on proposals for the disclosure of long positions held as contracts for difference (CFDs) set out in its consultation paper published in November 2007 (as reported in the December edition of *London Update*). The FSA has announced that it will implement a general disclosure regime for long CFD positions. The initial disclosure threshold will be at 3%, in line with the existing UK disclosure rules for positions in equity securities. The FSA proposes to exempt CFD writers which act as intermediaries in order to reduce unnecessary disclosures. The feedback statement contains draft rules, and the FSA will accept technical comments on the rules until January 23, 2009. The FSA expects to issue final rules in February 2009 which will come into effect September 1, 2009.

www.fsa.gov.uk/pubs/cp/cpo8_17.pdf

FSA Publishes Feedback on Unauthorised Trading and Market Abuse Controls

On October 30, the FSA published its latest *Market Watch* newsletter, *Market Watch 29*. The newsletter provides an update on market conduct and transaction reporting issues such as unauthorised trading, market abuse controls, technical reporting specifications for reporting derivatives and transaction reporting.

Particularly, the newsletter highlights the FSA's findings from its continuing work with respect to systems and controls necessary to deter and detect unauthorised trading. Specifically, the FSA has been interested in such things as front office culture and governance, trading mandates and limits, risk management and limits, use of management information, use of off-market rates, attribution of profit and losses, confirmations, margining, collateralisation and cash management and the segregation of duties and IT security.

Market Watch 29 also includes feedback from the FSA's follow-up visits to hedge fund managers on market abuse controls. The feedback addresses firm culture and senior management responsibility, compliance, the control of inside information, monitoring of trading activity, training, personal account dealing and use of telephone taping.

www.fsa.gov.uk/pubs/newsletters/mw_newsletter29.pdf

EU Developments

CESR Members Enhance Supervisory Cooperation for Branch Supervision

On September 3, the European Union's Committee of European Securities Regulators (CESR) published a progress report on the protocol for branch supervision which was introduced as part of the implementation of the EU Markets in Financial Instruments Directive (MiFID). CESR has reported that 16 agreements for cooperation on the supervision of branches have been concluded between CESR members.

The protocol created two models for cooperation between CESR members: (i) joint supervision conducted through common oversight programs, or (ii) joint supervision through requests for assistance based on efficient allocation of supervisory tasks.

www.cesr.eu/popup2.php?id=5183

European Parliament Calls for Regulation of Hedge Funds and Private Equity

On September 23, the European Parliament adopted a report demanding regulation of private equity funds and hedge funds. The Parliament formally requested that the European Commission propose legislation before December 2008.

Parliament's detailed recommendations of matters to be covered by the Commission regulations included:

- Capital requirements,
- Greater disclosure of investment policy and risks,
- Increased transparency requirements with respect to prime brokers,
- A harmonised EU framework for venture capital and private equity,
- Prevention of asset stripping by private equity vehicles, and
- Enhanced requirements for management of conflicts of interest.

Generally, the Commission was instructed to examine all existing EU financial market legislation and identify any lacunae regarding the regulation of hedge funds and private equity and to submit proposals for plugging such gaps.

The Commission was also instructed to submit a proposal for the establishment of a European Union private placement regime allowing for cross-border distribution of investment products, including alternative investment vehicles, to eligible groups of sophisticated investors.

www.europarl.europa.eu/oeil/file.jsp?id=5558452

European Commission Publishes Revised Capital Requirements Proposals

On October 1, the European Commission published its proposals to revise the EU Capital Requirements Directive. The revisions are stated to have been prompted by the current financial market turbulence and to be aimed at ensuring adequate protection of creditor interests and overall financial stability.

The proposals focus on large exposures, risk retention in securitisations, the use of so-called supervisory “colleges”, and consistent treatment of tier one capital and liquidity risk.

The Commission believes that the current large exposures regime leads to high costs and a lack of clarity. Particularly, the Commission is concerned that the present regime fails to tackle potential market failures such as inter-bank exposures. An amended limit-based backstop regime for large exposures is to be introduced and the Commission proposes to limit inter-bank exposures to the higher of 25% of the lending bank’s own funds or €150 million.

The proposals include a requirement designed to address potential conflicts of interest in the “originate to distribute” model by requiring originators and sponsors of credit risk transfer to retain at least 5% of the risks they have underwritten. The Commission has also made proposals aimed to create an efficient structure for supervisory colleges to facilitate information sharing and coordination among the supervisors of large cross-border groups of companies.

The proposals will amend European Directives 2006/48/EC and 2006/49/EC and now pass to the European Parliament and the European Council of Ministers for consideration under the EU’s co-decision procedure.

http://ec.europa.eu/internal_market/bank/docs/regcapital/crd_proposal_en.pdf

CESR Publishes MiFID Supervisory Briefings

On October 6, CESR published several briefings on key elements of the EU Markets in Financial Instruments Directive. The briefings were published as part of CESR’s work to promote supervisory convergence across the EU and are aimed at regulators in EU Member States. The briefings covered conflicts of interest, best execution and inducements and summarise the main content of the rules.

www.cesr.eu/popup2.php?id=5287

www.cesr.eu/popup2.php?id=5288

www.cesr.eu/popup2.php?id=5289

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