London Update

UK Financial Services Regulatory Developments

Katten
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This edition covers UK and EU developments between 30 September and 31 October

UK DEVELOPMENTS

FSA Publishes Feedback to Turner Review

On 30 September, the Financial Services Authority (FSA) published a response to the feedback it had received on the Turner Review and the related discussion paper DP09/2, both published on 18 March (as reported in the April edition of *London Update*). The Turner Review, led by Lord Turner, the FSA Chairman, considered the underlying causes of the financial crisis and recommended a regulatory response stressing the importance of future regulation and supervision being based on a different approach to regulatory risk.

The response sets out the FSA's analysis of the feedback received and reports on the progress made since March in implementing changes and in achieving international agreement. Generally, the feedback received agreed with the analysis set out in the Turner Review and the broad approach it proposed. The majority of respondents offered clear support for the analysis of the causes of the financial crisis, the main recommendations and the FSA's supervisory approach as detailed in the Turner Review and the discussion paper.

The feedback raised the following key issues:

- Respondents agreed upon the need for an international approach when looking at policy options.
- Respondents raised concerns that any measures implemented by the UK alone could damage London's competitiveness in the global market.
- Large firms were opposed to increasing requirements for systemically important firms.
- Respondents considered that an impact assessment of the "whole package" of reform was needed.

The issue of most concern for respondents was the need for international consistency in formulating and implementing the regulatory policy response to the global financial crisis.

In his foreword to the response, Lord Turner stated that "wider debate has continued on the overall approach to financial regulation and the FSA's own thinking has continued to evolve". The FSA noted that some issues were covered only to a limited extent in the Turner Review and required a more detailed analysis. As a result, the FSA published a further discussion paper on 22 October which focused in particular on policy measures to address the problem of systemically important "too-big-to-fail" banks. It also examined the trade-offs involved in increasing capital and liquidity requirements and stressed the need to assess the cumulative impact of multiple reforms.

The discussion paper further identified the dangers posed by those firms that are seen as too big or too interconnected to fail, or too big to rescue. It described the full range of policy options—including the creation of "narrow banks"—in order to provide the basis for an informed debate. It also outlined the position which the FSA is currently proposing in international fora.

The full text of the FSA's 30 September response can be found here.

To read the 22 October discussion paper click here.

FSA Sets Out Its Policy on Short Selling

On 1 October, the FSA published FS09/04, a feedback statement to DP09/01, its February 2009 discussion paper (see the March edition of *London Update*). In FS09/04, the FSA sets out its policy approach to short selling and addresses the responses to DP09/01 and market developments since its publication.

The FSA does not intend its current disclosure regime (disclosure of net short positions of 0.25% or more of the issued share capital of UK financial services companies or companies carrying out a rights issue) to apply permanently and intends at a future date to replace it with a permanent regime, which will apply to short positions in all UK issuers.

Since DP09/01 was published in February, the Committee of European Securities Regulators (CESR) has issued proposals for a short selling disclosure regime. CESR proposals include public disclosures of significant short positions at the level of 0.5% and private disclosures to regulators at the lower level of 0.1% (see the August edition of *London Update*).

To read FS09/04, click here.

Court of Appeal Rules FSA Can Prosecute Offenses Not Specified in Statute

In early October, the Court of Appeal ruled that the power of the FSA to prosecute criminal offenses was not limited to the offenses specified in sections 401 and 402 of the Financial Services and Markets Act 2000. In particular, the Court of Appeal ruled that the FSA has the power to prosecute money laundering and other offenses within the ambit of the FSA's statutory objectives.

To read the Court of Appeal's judgment click here.

UK Regime for Registration of Charges Created by Non-UK Companies Simplified

The Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 (RoC Regulations) now provide that (a) no "Slavenburg" registrations of charges created after 30 September will be accepted and (b) charges may only be registered against foreign companies which have a place of business in the UK registered with the Registrar of Companies.

The practice of filing Slavenburg registrations originated from the 1980 High Court Slavenburg Bank decision. This led to a concern that where a charge was created under English law by a company without an established and registered UK place of business and the charging company subsequently set up business in the UK, the unregistered charge would be void for not being registered within 21 days after its creation or within 21 days of the date when the non-UK company established and registered a UK place of business.

The pre-1 October solution to this problem was to deliver the charge to the Registrar of Companies. Such deliveries were noted on the Slavenburg register and this prevented the charge from being considered void on a subsequent registration by the foreign company of a UK place of business.

This problem has now been solved by the RoC Regulations. There is now no obligation to deliver to the Registrar of Companies charges created by non-UK companies which have not registered a place of business in the UK. The Registrar will no longer accept Slavenburg registrations in respect of charges created on or after 1 October.

FSA Publishes Liquidity Requirements Rules

On 5 October, the FSA published PS09/16. This Policy Statement follows from the FSA's consultation on strengthening liquidity standards, which began in December 2008 (see the January edition of *London Update*) and contains final rules on the liquidity requirements applicable to regulated firms. The new rules are designed to enhance firms' liquidity risk management practices. Specific new rules include:

- an updated quantitative regime coupled with a narrow definition of liquid assets;
- over-arching principles of self-sufficiency and adequacy of liquid resources;

- enhanced systems and controls requirements;
- more frequent reporting requirements; and
- a new regime for foreign branches that operate in the UK.

The FSA stated that it will not tighten quantitative standards before economic recovery is assured. It plans to phase in the quantitative aspects of the regime in several stages, over an adjustment period of several years. The qualitative aspects of the regime will be put into place by December 2009.

The FSA considers that it has made the structure of its new regime sufficiently flexible to allow the FSA to modify it so as to reflect any new international standards introduced in the short to medium term.

To read PS09/16, click here.

FSA Fines Firm for Failure to Prevent Employee Fraud

On 8 October, the FSA announced that it had fined Seymour Pierce Limited, a stockbroker, £154,000 for a breach of FSA Principle 3 by failing to take reasonable care to organize and control its affairs responsibly and effectively with adequate risk management systems, as it had failed to establish effective measures to prevent employee fraud in its settlement department.

A former Seymour Pierce employee was able to steal approximately £150,000 in 36 separate transactions over a three-year period. The theft was undetected until, after the employee's dismissal, his replacement pointed out serious accounting discrepancies.

Margaret Cole, the FSA's Director of Enforcement and Financial Crime, commented: "This is a serious failure on Seymour Pierce's part. The frauds were not sophisticated and could have been detected at a much earlier stage if the proper procedures had been in place."

Seymour Pierce agreed to settle at an early stage of the investigation, meaning it qualified for a 30% discount. Without the discount, the fine would have been £220,000. The FSA took into account a number of mitigating factors: Seymour Pierce cooperated fully with the authorities once the frauds had been discovered, instigated internal reviews into the failings and implemented new systems to protect against future failings. The firm also took steps to ensure that its affected clients were fully reimbursed.

Read more.

FSA Writes to CEOs to Clarify Issues Regarding Significant Influence Functions

On 12 October, the FSA sent a letter (the CEO Letter) to the CEOs of its 5,000 relationship managed firms to clarify its approach to approval and supervision of persons performing significant influence functions (SIFs).

In July 2009, the FSA extended its approved persons registration regime to include a wider range of persons performing functions considered to be SIFs at any FSA authorised firm. It had also announced that it would place greater emphasis on the role of senior management, including non-executive directors (as reported in the August edition of *London Update*).

The CEO Letter sets out the FSA's competence expectations of SIF holders. It states that the FSA expects senior management to be able to demonstrate their understanding of the inherent risks in the business/markets in which the firm is active and to articulate what plans are in place to mitigate the risk of failure. The letter also emphasises that "as a critical component of our credible deterrence philosophy" the FSA "will take tough enforcement action" against approved persons where it finds evidence of culpable misconduct or a breach of principles due to competence failures—as well as cases of dishonesty and lack of integrity.

The CEO Letter also explains the approval process for firms' candidates applying to perform SIFs and gives details on the way in which interviews, a newly introduced element of the approval process designed to help the FSA assess the candidate's fitness and propriety, will be used. Interviews will typically take place at the FSA's offices and will last about 90 minutes. They will explore a range of issues including the knowledge, skills and experience that the individual will bring to the SIF role, the individual's view of the main risks facing the firm and the FSA's expectations of the individual in performing the role.

To read the CEO letter in full, click here.

Overseas Banks Commit to FSA Rule on Remuneration Practices

On 14 October, the UK Treasury announced that UK subsidiaries and branches of the following eight leading overseas banks—Bank of America Merrill Lynch, Citigroup, Credit Suisse, Goldman Sachs International, JP Morgan Securities Ltd, Morgan Stanley, Nomura and UBS—have confirmed their commitment to the FSA Rule on remuneration practices and the supporting Code, which was published in August and is due to come into force on 1 January 2010 (as reported in the September edition of *London Update*). The eight have also confirmed their full support for the Group of Twenty (G20) agreement, which sets global standards for the implementation of the Financial Stability Board's remuneration principles.

Three EU banks with major London branches, BNP Paribas, Deutsche Bank and Société Générale, have also confirmed that they will implement the G20 agreement in accordance with their home regulator and will seek to voluntarily comply with the FSA Rule on Remuneration for their UK-based employees.

Read more.

FSA Impact Assessment Criticizes Proposed AIFM Directive

On 15 October, the FSA published an independent impact assessment report on the proposed Alternative Investment Fund Manager Directive which had been carried out on the FSA's behalf by a firm of consultants. The assessment was based on the Directive as originally drafted in April 2009. (For more information on the Directive see the August edition of *London Update* and the 6 May Katten *Client Advisory*.) Its key conclusions were that the Directive would have significant impacts in terms of reduced investor choice and substantial compliance costs for the alternative investment fund industry. Costs would be passed on to investors and would ultimately result in lower returns.

To read the report, click here.

EU DEVELOPMENTS

CESR Chairman Criticizes Draft AIFM Directive

On 9 October, it was reported that Eddy Wymeersch, Chairman of CESR, had said in an interview that the draft EU Alternative Fund Managers Directive was unworkable and needed to be rethought. Mr. Wymeersch went on to say that he hoped that the European institutions involved in the process "will come forward with something more balanced. It really doesn't work. They have pooled everything together, the scope is absolutely too wide, everything is caught."

Read more.

European Commission Issues Communication on Derivatives Markets

On 21 October, the European Commission released a communication entitled *Ensuring Efficient, Safe and Sound Derivatives Markets: Future Policy Actions*. The communication sets out the Commission's intended future policy designed to increase transparency of the derivatives market, to reduce counterparty and operational risk in trading, and to enhance market integrity and oversight. The communication follows from the consultation launched by the Commission in July (as reported in the August edition of *London Update*). The Commission will make legislative proposals in 2010.

In the communication, the Commission states that it "believes that a paradigm shift must take place away from the traditional view that derivatives are financial instruments for professional use, for which light-handed regulation was thought sufficient, towards an approach where legislation allows markets to price risks properly. As a result, the proposed measures will shift derivative markets from predominantly OTC bilateral to more centralized clearing and trading."

To read the communication click here.

European Commission Publishes Further Proposals on EU Financial Supervision

On 26 October, the European Commission published draft legislative proposals on measures designed to strengthen the supervision of the EU financial sector. These follow the proposals announced on 23 September (as reported in the October edition of *London Update*).

The legislative proposals amend existing European financial services legislation and aim to ensure that the new European Supervisory Authorities (ESAs) are able to work effectively. In particular, the proposals cover the following:

- defining the scope in which the ESAs will be able to propose technical standards for supervisory convergence, with a view to developing single European Economic Area-wide rule books;
- integrating the ESAs' ability to settle disagreements between national supervisors into areas where common decision-making processes already exist; and
- general amendments to enable existing European legislation to operate in the context of the new ESAs and to establish appropriate mechanisms for the exchange of information among national regulators.

To view the proposals, click here.

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