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 August and 31 August

UK DEVELOPMENTS

FSA Introduces Remuneration Code of Practice

On 12 August, the UK Financial Services Authority (FSA) introduced a remuneration code of practice (the Code). It requires UK banks with regulatory capital exceeding £1 billion and investment firms with regulatory capital exceeding £750 million to establish, implement and maintain remuneration policies consistent with effective risk management. Currently 26 firms fall within the Code's regulatory capital scope.

The Code introduces a new rule that requires firms within its scope to have in place remuneration policies consistent with effective risk management. The FSA has also added eight principles to the Systems and Controls (SYSC) module of its handbook designed to clarify how the FSA will assess compliance with the Code.

Although the Code applies directly only to the largest UK regulated firms, the FSA has indicated that it expects all banks, broker-dealers, investment managers and building societies to take note of its provisions since it represents the FSA's view on good practice for all firms.

The FSA stated that the fundamental objective of its remuneration policy is to sustain market confidence and promote financial stability through removing the incentives for inappropriate risk taking by firms, and thereby to protect consumers. It considers the need to ensure that remuneration policies and practices are consistent with and promote effective risk management to be fundamental. The FSA expects firms' boards of directors and senior management to focus on ensuring that the total remuneration amounts distributed by firms are consistent with good risk management and that individual compensation practices provide the "right incentives".

Changes to policies and procedures should be fully in place by 1 January 2010, and changes to remuneration structures and contracts should be implemented with effect from 1 January 2010.

Read more.

FSA Restates Its Approach on Informal Guidance

The FSA has restated its approach (in the context of regulation and enforcement) to the various types of informal guidance it employs.

The FSA uses informal guidance and supporting material to supplement its rules and formal guidance and to assist firms' understanding of what the FSA expects of them. This includes case studies, examples of good and bad practice, speeches made by FSA personnel, "Dear CEO" letters and industry guidance which has been confirmed by the FSA.

The FSA stated that informal guidance and other supporting material that the FSA issues is not binding on regulated firms. The FSA intends that material illustrate ways (but not the only ways) in which regulated firms can comply with the relevant rules.

The FSA will not take action against a person for behaviour that it considers to be in line with FSA guidance, supporting material or FSA-confirmed industry guidance that was current at the time of the behaviour in question. The FSA's view is that

guidance and supporting material do not set out minimum standards of conduct needed to comply with rules, nor is there any presumption that departing from FSA guidance indicates a breach of a rule. If a regulated person or firm has complied with the FSA's Principles and rules, then it does not matter whether it has also complied with other material that the FSA has issued.

The FSA took care to point out that rights conferred on clients of regulated firms and other third parties are not directly affected by FSA guidance or its supporting material since it does not bind the courts (e.g., in relation to an action for damages for breach of an FSA rule). Nonetheless, it is at the very least rebuttable evidence of the construction of any relevant provision.

Read more.

FSA Addresses Potential Issues for Activist Shareholders

On 19 August, the FSA issued clarification of the manner in which certain of its rules apply to activist shareholders wishing to work together.

The FSA addressed three areas of its rules: the market abuse regime, disclosure of substantial shareholdings and changes in control:

- Trading on the basis of knowing another investor's intentions or working jointly to avoid disclosure of shareholdings will generally constitute market abuse. On the other hand, market abuse rules do not prevent investors from engaging collectively with the management of an investee company.
- The FSA rules on disclosure of major shareholdings require that investors who have agreed to pursue the same long-term voting strategy must aggregate their shareholdings for the purpose of disclosure thresholds. This disclosure obligation is not likely to be triggered by ad hoc discussions between investors on particular corporate issues.
- Under the EU Acquisitions Directive, where investors are "acting in concert" they require FSA approval if they reach a controlling shareholding (10% or more of a company's shares) in firms regulated by the FSA. "Acting in concert" is not defined in the Directive. The FSA does not view ad hoc discussions or understandings between investors intended solely to promote generally accepted principles of good corporate governance in firms in which they have invested to be "acting in concert" for this purpose.

Read more.

FSA and CFTC Announce Regulatory Cooperation in Surveillance of Oil Markets

On 20 August, the FSA and the Commodity Futures Trading Commission (CFTC) announced an agreement designed to strengthen cross-border supervision of the energy futures markets.

The FSA and CFTC stated that they will immediately work together towards implementing strengthened surveillance over U.S.-linked energy contracts including, where appropriate:

- enhanced direct access rights to trade execution and audit trail data;
- mutual on-site visits to exchange operators;
- the sharing of exchange regulations and notices;
- the sharing of disciplinary notices; and
- coordination of emergency action.

Read more.

FSA Issues *Market Watch* 33

The FSA published issue 33 of its *Market Watch* newsletter on 28 August. It includes articles warning about order book manipulation and emphasising the importance of Suspicious Transaction Reports (STRs) in preventing and detecting insider dealing.

The FSA highlighted conduct termed "layering" and "spoofing" in particular as manipulation of the order book for firms who offer direct market access (DMA) to their clients. This refers to the use of multiple orders which may give a false or misleading impression about the supply and demand for securities.

The FSA considers that such behaviour can constitute market abuse and stated that it expects DMA providers to have appropriate systems and controls in place to identify and prevent it just as exchanges and multilateral trading facilities are required to do.

The FSA stated that in general it considers that the market abuse STR regime is working well, pointing out that suspicious transactions sometimes come to its attention where the firms involved have not submitted an STR, although the FSA would have expected to receive one. As a result, the FSA is "increasingly initiating telephone contact with firms as a matter of course in these cases". The regulator wants to understand why firms do not submit STRs. It also explained that these phone calls will help it to identify where a firm's practices may have fallen below the standards expected under the rules and that in appropriate cases this will lead to disciplinary action.

Read more.

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