C L I F F O R D
C H A N C E

FSA Update

14 February 2011

At the FSA in the last week:

- **Fine and ban for market abuse**

The Upper Tribunal (Tax and Chancery Chamber) has directed the FSA to fine David Massey £150,000 and ban him from performing any role in regulated financial services for engaging in market abuse. On 1 November 2007, Mr Massey short sold 2.5million shares of Eicom, the then AIM-listed digital broadcaster, at 8p per share on the basis of the inside information that Eicom was intending to issue new shares at 3.5p per share. Within minutes he accepted an offer to subscribe for 2.6million newly issued Eicom shares at 3.5p and used the shares he obtained to close his short position, making a net profit of over £100,000. Mr Massey, then a Corporate Finance Executive at Zimmerman Adams International, had also occasionally acted as a financial PR consultant for Eicom for approximately five years, sometimes receiving payment from Eicom for his services. In and after June 2007 Eicom was in discussion with Mr Massey about its need for further funds for a possible acquisition. At the time of his short sale of Eicom shares, he knew that Eicom was prepared to issue up to 3million shares to him at a substantial discount. Following the trading, he initially tried to book the transaction to the account of an associate and, when questioned about the deal by Zimmerman Adams International and its compliance advisors, he gave the impression that he hardly knew Eicom.
http://www.tribunals.gov.uk/financeandtax/Documents/decisions/DavidMassey_v_FSA.pdf
http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/021.shtml

- **Ban for lack of FSA approval**

The FSA has banned Daniel Hassell from working in regulated financial services. The FSA found that Mr Hassell knew that the FSA was not satisfied that he was a fit and proper person to perform a significant influence function. Despite this, he performed a function at a City firm for four years without obtaining the FSA's approval. Vantage Capital Markets LLP (Vantage), an interdealer broker, was formed as a limited liability partnership in 2004 and during Mr Hassell's time at the firm it had three capital partners. Mr Hassell was not a capital partner, but despite a job title of 'consultant', exercised a significant influence over Vantage. The majority of the brokerage business was previously owned by Mr Hassell and generated around half of Vantage's revenues. Mr Hassell received approximately one third of the firm's profits, the remainder being shared between the capital partners. Mr Hassell was, on occasion, presented as an owner in correspondence and was seen as such by some of the Vantage staff. FSA rules require those performing significant influence functions to be approved persons. At the time of its authorisation Vantage applied for Mr Hassell to be an approved person as partner of Vantage. However he was the subject of an FSA investigation. The FSA informed Vantage of its concerns about Mr Hassell and Vantage withdrew the application. In February 2007, the FSA told Mr Hassell that he was no longer being investigated. Vantage applied again for approval for him, but withdrew the application after the FSA indicated that it would not approve Mr Hassell to perform a significant influence function due to issues arising from the investigation. Despite this he continued to exercise a significant influence over the firm until an FSA supervisory visit in 2009. He did not take steps to limit the remit of his role and influence at Vantage. The effect was that he was able to exercise a significant influence over the activities

Headlines

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Consultation Paper issued on client money and asset return

Policy Statement published on second Electronic Money Directive

Dear CEO letter explains transition to new regulatory structure

Retail Distribution Review newsletter published

New draft code of practice for auditors and supervisors

FSA speaks about insurance regulation

Issue 92 of Ombudsman News published

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of Vantage without any oversight by the FSA.
http://www.fsa.gov.uk/pubs/final/daniel_hassell.pdf

- **Consultation Paper issued on client money and asset return**

  The FSA has published Consultation Paper CP11/4: "The Client Money and Asset Return (CMAR): Operational Implementation". The Paper sets out the FSA's proposals on how firms should report information on client money and assets through its online reporting system GABRIEL. In particular, the FSA is proposing that:

  - CASS medium and large firms will need to submit the client money and asset return on a monthly basis; and
  - CASS small firms will not initially have to submit the return, but instead will have to complete a half-yearly survey to notify the FSA of their highest client money balance and value of client assets.

  The FSA has invited comments on some of the proposals in CP11/04 by 10 April 2011 and on others by 10 March 2011. The FSA has indicated that it intends to publish a policy statement on implementing the client money and asset return for medium and large firms in May 2011, and that the rules will enter into force on 1 June 2011. In addition, it intends to publish a Handbook Notice in relation to small firm reporting requirements in April 2011. http://www.fsa.gov.uk/pubs/cp/cp11_04.pdf

- **Policy Statement published on second Electronic Money Directive**

  The FSA has published Policy Statement PS11/2: "Implementation of the second Electronic Money Directive: supplement to HM Treasury's consultation – Feedback on CP10/25 and part of CP10/24,and final rules". The Directive was adopted by the EU Parliament and the Council on 16 September 2009, and must be transposed into UK law by 30 April 2011. HM Treasury is implementing it through the Electronic Money Regulations 2011, and PS11/2 sets out the FSA's final rules to enable it to carry out its responsibilities. These do not differ significantly from the proposals set out in the FSA's October 2010 consultation papers CP10/25 and CP10/24. http://www.fsa.gov.uk/pubs/policy/ps11_02.pdf

- **Dear CEO letter explains transition to new regulatory structure**

  The FSA has published a "Dear CEO" letter providing an update on its plans for the transition to the new regulatory structure announced by the Chancellor of the Exchequer in his Mansion House speech on 16 June 2010. The letter reminds CEOs that the government intends to replace the FSA with:

  - the Prudential Regulation Authority (PRA), which will be a subsidiary of the Bank of England, and responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks; and
  - the Consumer Protection and Markets Authority (CPMA), which will be responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets.

  The letter indicates that the FSA is making changes to its current management structure to help it evolve from one unitary regulator into the proposed new structure over the next two years. These changes will begin on 4 April 2011, when the FSA will replace its current Supervision and Risk business units with a Prudential Business Unit (PBU) and a Consumer & Markets Business Unit (CMBU). Hector Sants will be the chief executive of the PRA as well as head of the PBU, and will be supported by Andrew Bailey, who will join the FSA on 4 April 2011 as a Bank of England secondee to act as the deputy head of the PBU. Martin Wheatley will be chief executive of the CPMA as well as head of the CMBU. The letter emphasises that the reorganisation is only the beginning of a gradual process of change to ensure that the FSA is ready to move to the 'twin peaks' approach to supervision in 2012, and that integrated supervision will continue until new regulatory processes have been designed and piloted and staff have been trained. The FSA has also published an organisation plan illustrating the changes described in the letter. In addition, the FSA intends to publish papers during the first half of 2011 providing more detail on its approach to the transition to regulation by the CPMA and PRA and their emerging philosophies.
  http://www.fsa.gov.uk/pubs/international/dceo_transition.pdf

- **Retail Distribution Review newsletter published**

  The FSA has published issue 1 of its Retail Distribution Review newsletter, which looks at the role of platforms in a RDR world, "myth busting" and the RDR timetable,
  http://www.fsa.gov.uk/pubs/newsletters/rdr1.pdf

- **New draft code of practice for auditors and supervisors**

  The FSA and the Bank of England have produced a draft code of practice which the FSA says is designed to enhance the dialogue between auditors and supervisors. The aim of the code is to improve audit effectiveness and ensure that supervisors are better informed about, and able to challenge, the firms they regulate. Principles are set out in the code for auditors and supervisors to follow when they deal with regulated firms. These

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cover the nature of the relationship between the supervisor of a regulated firm and the firm's external auditor, how often and in what form they should be communicating with each other and the way that information should be shared between them. For certain firms, the code specifies a minimum level of formal meetings between the supervisor, the external auditor and the firm. It also encourages discussions through informal channels to help both supervisors and auditors fulfill their responsibilities towards regulated firms and enhance the effectiveness of the supervisory and audit process. Responses are sought by 25 March 2011.
http://www.fsa.gov.uk/pages/Library/Policy/guidance_consultations/2011/11_05.shtml

- **FSA speaks about insurance regulation**

  Hector Sants, the FSA's Chief Executive, spoke on Wednesday about the future of insurance regulation, in which he focused on Solvency II and the new supervisory structure in the UK. Mr Sants argued that Solvency II will, amongst other things, improve risk and market sensitivity, the supervision of groups, and transparency, while also creating a set of common EU intervention tools and reducing cross-subsidisation. He noted that concerns have been raised as to whether the costs of implementation are disproportionate to these benefits and whether the risk calibration is correct. In this context, Mr Sants emphasised that it has not been the FSA's ambition to increase or decrease the amount of capital supporting the UK insurance industry, but rather to ensure that capital was more appropriately aligned with risks. He acknowledged that for some UK firms there may be some increase in capital. However, he argued that, overall, this should not outweigh the benefits of a more stable and resilient regime. Mr Sants also noted that there remain a number of outstanding issues which require further debate, including equivalence and own funds, the relevance of the standard formula, and the relevance of the illiquidity premium in technical provisions. Finally, he indicated that the FSA is currently in the process of refining its proposed implementation methodology for Solvency II and will shortly communicate the implications of this for individual firms.

  On the subject of the UK's new supervisory structure, Mr Sants outlined the future roles of the Prudential Regulation Authority (PRA) and the Consumer Protection and Markets Authority (CPMA). He stated that the PRA will build on the FSA's recently developed approaches – its intrusive and judgement-based supervision, based on its 'core prudential programme' of oversight and credible deterrence, but that there are areas where further change is needed, particularly given the PRA's new statutory objective. Mr Sants also argued that the PRA's regulatory approach to insurers should take into account the different nature of prudential supervision in relation to insurers as opposed to banks. In particular, he argued that there should be greater emphasis on going concern issues over gone concern issues in comparison with a bank. However, despite acknowledging the differences between banks and insurers, Mr Sants emphasised that the PRA will base its supervisory interventions for both banks and insurers on a similar judgment-based risk assessment framework. He stressed that the goal for the PRA is to introduce a formal, proactive intervention framework so that concerns about individual firms are elevated quickly and remedial action taken to reduce the probability of failure.

  Turning to the CPMA, Mr Sants indicated that its regulatory approach will be delivered using a risk model which puts a premium on early risk identification and prioritisation. According to Mr Sants, the aim is for the CPMA to use this risk identification to put itself in a position to intervene earlier, well before consumers have been harmed. He also noted that, in order to achieve this goal, the CPMA will need to be given more powers of intervention and disclosure than the FSA currently has. Mr Sants also emphasised that, in moving to a structure where prudential and conduct supervision is no longer integrated, a key measure of success for the wider regulatory landscape will be effective coordination between the new bodies.
  http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0209_hs.shtml

And you may be interested to know:

- **Issue 92 of Ombudsman News published**

  The Financial Ombudsman Service has published issue 92 of Ombudsman News, which looks at disputes about how insurance claims are settled, and also contains third quarter statistics.
  http://www.financial-ombudsman.org.uk/publications/ombudsman-news/92/92.pdf

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