

30 January 2012

At the FSA last week: -

FSA imposes £7.5 million in fines for market abuse by hedge fund

In several significant decisions underlining the responsibilities of market participants in relation to the use of inside information, the FSA has imposed financial penalties totalling almost £7.5 million on Greenlight Capital Inc ("Greenlight") and its owner David Einhorn for market abuse, and on its former compliance officer and a trader who sold shares on its instructions for breaches of the FSA's Statements of Principle and Code of Practice for Approved Persons ("APER").

The fines imposed relate to sales by Greenlight in June 2009 of shares held by it in Punch Taverns plc ("Punch"). These sales followed a telephone call with a corporate broker acting on behalf of Punch, in which Mr Einhorn, together with others, participated and in which the broker informed participants that Punch was at an advanced stage of progressing towards a significant equity fundraising. Mr Einhorn, who had, prior to the telephone call, declined to be "wall crossed", gave instructions shortly after the call that Greenlight's holding in Punch should be sold.

The FSA, through the Regulatory Decisions Committee ("RDC"), has decided that, although the information

shared by the broker during the telephone call was not expressly stated to be inside information, Mr Einhorn should have drawn appropriate inferences and interpreted the information as inside information, and that therefore the subsequent disposals of Punch shares constituted market abuse by him and Greenlight.

The RDC acknowledged that Mr Einhorn's actions were not deliberate or reckless. Nonetheless, the penalties imposed on both Greenlight (£3,650,795) and Mr Einhorn (£3,638,000) are significant, and the RDC has sought to send a strong message in relation to the caution which prominent market participants must exercise when dealing with brokers. In a further interesting aside, the significant disgorgement components of both penalties (£650,795 and £638,000 respectively) continued the trend of the FSA's taking action not only where firms and individuals have made a gain from engaging in market abuse, but also where they have avoided a loss by doing so.

Although the FSA has at this stage published Decision Notices rather than Final Notices in respect of Mr Einhorn and Greenlight, it is understood that they will not be seeking to pursue matters to the Upper Tribunal.

In separate action, the FSA has banned Greenlight's former compliance officer from performing approved functions CF10 (compliance oversight) and CF11 (money laundering reporting) and imposed a financial penalty of £130,000 on him in respect of breaches of Principle 6 of APER (significant influence functions: due skill, care and diligence) for failing to make reasonable

enquiries prior to effecting the order for Greenlight's Punch shares to be sold.

The FSA has also fined a trader £65,000 for breaching Principle 2 of APER (due skill, care and diligence) for a failure to failing to identify the order for the sale of Greenlight's Punch shares as suspicious and act upon it.

<http://www.fsa.gov.uk/library/communication/pr/2012/005.shtml>

<http://www.fsa.gov.uk/library/communication/pr/2012/007.shtml>

Key issues

- FSA imposes £7.5 million in fines for market abuse by hedge fund
- Key FCA figures set out their vision for the new regulator's approach
- FSA invites views on potential impact of Alternative Investment Fund Managers Directive
- FSA announces proposed changes to Listing Rules
- FSA publishes proposed guidance on transaction reporting in relation to strategy trades on Alternative Instrument Identifier ("AII") exchanges
- FSA proposes changes to Large Exposures regime rules and guidance
- Financial Services Bill published

Key FCA figures set out their vision for the new regulator's approach

Martin Wheatley, who will take control of the Financial Conduct Authority ("FCA"), when it comes into being in early 2013, has spoken about the approach which the FCA proposes to take to conduct regulation, and the challenges currently facing the FSA, and which will face the FCA in developing a "new orthodoxy".

In his speech to the British Bankers Association last week, he argued that traditional orthodoxies, which have underpinned not only firms' business models, but also consumers' behaviour and the FSA's approach, specifically those that people make rational decisions when given sufficient information, that markets are self correcting and that overseeing the distribution channels ensures that the right products get to the right people, have failed.

He acknowledged that consumers retain responsibility for their actions, but made it clear that the FSA has now made fundamental changes to its approach to regulation, particularly in the area of consumer protection. Referring to some changes which are already at an advanced stage of implementation, such as a more intrusive approach to product design and governance, and also others which will depend upon the passage of legislation, such as the proposed product intervention powers set out in the Financial Services Bill, he stated that the FCA going forward aims to be

a regulator that "asks the difficult questions, the ones that sometimes regulators have shied away from, of [firms], of ourselves [and] of consumers' behaviour".

Giving some preliminary indications of how this more hands on approach to consumer protection regulation is proposed to look in practice, he made clear that the FCA, in a shift from the approach historically taken by the FSA, will much more intrusively test that consumers' experiences in reality correspond with commitments made by senior management about systems and controls in place, including by asking more questions about how firms' business models will align with consumers' expectations and by greater scrutiny of how firms deal with their customers "at front line level".

Some further guidance on how the proposed regulatory approach is likely to feel for firms was given in a speech given by Clive Adamson, Director of Supervision in the FSA's Conduct of Business Unit (the predecessor body to the FCA). He reiterated that, at its most intensive, the new FCA approach will go further than the ARROW process it replaces to examine individual aspects of firms' business models and strategies to ensure that consumer focus is not subjugated to financial profitability and prudential strength. He added that there will be a greater expectation by the FCA that firms will elevate conduct issues up their board agendas and pre-empt problems before they arise, and that there will be higher levels of engagement by the FCA with large firms at board level to ensure that this happens.

Both indicated that the FSA will continue to give guidance as to how it, and the FCA from 2013 onwards, propose to regulate conduct, as the

scope of their powers and responsibilities become clearer as the Financial Services Bill progresses through Parliament.

Firms do not have to wait long for the next instalment of guidance from the FSA on the impact of the significant changes to conduct regulation. Hector Santos is expected to give a keynote speech within the next week giving further details on how regulation will work in practice for dual-regulated firms in the new regulatory landscape.

<http://www.fsa.gov.uk/portal/site/fsa/menuitem.10673aa85f4624c78853e132e11c01ca/?vgnextoid=6ee060f62b415310VgnVCM1000044bc10acRCRD&vgnnextfmt=default>

FSA invites views on potential impact of Alternative Investment Fund Managers Directive

The FSA has published (on 23 January) a discussion paper (DP12/1) on the implementation of the Alternative Investment Fund Managers Directive ("AIFMD"), which it will implement in 2013.

AIFMD will directly regulate UK based fund managers which deem at least part of their regular business as managing alternative investment funds, some discretionary investment managers, operators of unregulated collective investment schemes, investment companies not employing an external fund manager and depositaries and custodians holding the assets of alternative investment

funds. AIFMD will also affect those who provide alternative investment fund managers with some services, including prime brokerage facilities and external valuation, client administration and marketing and distribution services.

Firms have been invited to send responses to the discussion paper to the FSA by 23 March.

<http://www.fsa.gov.uk/library/policy/dp/2012/12-01.shtml>

FSA announces proposed changes to Listing Rules

The FSA has published (on 26 January) a consultation paper (CP12/2) on proposed changes to the Listing Rules, Prospectus Rules and Disclosure Rules and Transparency Rules ("DTR").

The proposed changes aim to narrow the opportunities for the use of reverse takeovers as a route to listing for otherwise ineligible companies, clarify the UK Listing Authority's expectations of sponsors, make the management of advisory companies to "Externally Managed Companies" (i.e. companies where significant management functions are outsourced to offshore advisory firms) responsible for the prospectus contents. In addition, the consultation paper invites firms to comment on whether they consider that any changes need to be made to the Listing Rules to provide additional protection to investors, particularly in relation to premium listings.

Firms have been invited to send responses to the consultation paper to the FSA by 26 April.

<http://www.fsa.gov.uk/library/communication/pr/2012/006.shtml>

FSA publishes proposed guidance on transaction reporting in relation to strategy trades on Alternative Instrument Identifier ("All") exchanges

The FSA has issued (on 25 January) proposed guidance on transaction reporting of strategy trades (stock contingent trades whereby two or more legs that are dependent on each other are executed simultaneously). Specifically, the guidance states that each reportable leg of such trades should be separately reported, and sets out proposed guidance on the correct population of the venue identification field. This provides guidance in relation to Rule 17.4.1 of the FSA's Supervision Manual ("SUP").

Firms have been invited to send responses to the guidance consultation paper to the FSA by 22 February.

http://www.fsa.gov.uk/library/policy/guidance_consultations/2012/12-01.shtml

FSA proposes changes to Large Exposures regime rules and guidance

The FSA has published (on 26 January) a consultation paper (CP12/1) in relation to the Large Exposures regime. The paper aims to give guidance on how aggregate exposure should be calculated.

Firms have been invited to send responses to the consultation paper to the FSA by 26 April.

<http://www.fsa.gov.uk/library/policy/cp/2012/12-01.shtml>

Other Final Notices: -

The registrations of Great Financial Services Limited and Speedy INTL Limited as small payment institutions under Regulation 10(1)(h) of the Payment Services Regulations 2009 have been cancelled following failures to pay fees payable and to submit required regulatory information to the FSA.

<http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/final/gfs.pdf>

<http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/final/speedy-intl.pdf>

Further afield: -

Financial Services Bill published

The Financial Services Bill, which will govern the break-up of the FSA and which, it is proposed, will give the new FCA significant new powers, has been introduced to Parliament. The timetable for the progress of the bill through Parliament has not yet been set, but the transition to the new regulatory structures is still expected to be complete by early 2013.

In addition, the Bank of England and the FSA have published a draft memorandum of understanding setting out a high level framework for how the FCA and PRA will work together within the new regulatory system provided for by the bill.

<http://services.parliament.uk/bills/2010-11/financialservices.html>

http://www.bankofengland.co.uk/financialstability/overseeing_fs/mou.htm

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