FSA Update

6 February 2012

At the FSA last week:-

FSA imposes largest ever non-market abuse fine on an individual

The FSA has banned Mr Ravi Sinha from performing any regulated activity and has imposed a financial penalty of £2.687 million on him in respect of a false invoicing scheme run by him. Mr Sinha, the former UK CEO of JC Flowers UK Limited ("**JCFUK**"), was found to have breached Principle 1 (integrity) of the FSA's Statements of Principle for Approved Persons ("**APER**"), following his admissions that he fraudulently obtained €1,548,396.67 by issuing invoices to a company in which he JCFUK had invested, payable to himself. He also admitted that he had misled the CEO of the company to which the invoices were submitted and dishonestly concealed the fact that he had received the payments from JCFUK.

The penalty imposed, the largest ever to be issued to an individual in a non-market abuse case, comprises £1.367 million, proposed to be disgorged and returned to the victims of the fraud (or those who have made recompense to them in the intervening period since the fraud) and a punitive element of £1.5 million. The FSA, rejecting representations by Mr Sinha, who has recently been discharged from bankruptcy, that the proposed penalty should be reduced as it would cause him to be declared bankrupt again, decided that the penalty should be imposed at that level given the seriousness of the conduct.

The action followed prompt reporting of the issues to the FSA by JCFUK, whose conduct has not been criticised by the FSA, which acknowledges in the Final Notice issued to Mr Sinha that his conduct contravened the terms of his employment contract and JCFUK's Code of Ethics. The action by the FSA follows a decision that the matter would be more effectively dealt with by way of regulatory action, rather than by prosecuting Mr Sinha.

http://www.fsa.gov.uk/library/communication/pr/2012/009.shtml

FSA issues guidance on unfair contract terms

The FSA has (on 30 January) issued finalised guidance aimed at improving standards in consumer contracts. This guidance follows that previously issued by the FSA on different specific areas on this topic. The guidance, although not an exhaustive list of all the terms which the FSA will consider to be unfair, sets out in some detail the types of term which the FSA most commonly finds to be of concern and practical steps which it considers firms should take to ensure compliance with their obligations under the Unfair Terms in Consumer Contracts Regulations 1999 ("**the Regulations**") and Principles 6 (treating customers fairly) and 7 (communications with clients) of its Principles for Businesses. Specific guidance is given in relation to: -

- rights to unilaterally vary contracts;
- rights to terminate contracts;
- discretion to exercise contractual powers;
- rights to transfer obligations under contracts; and
- terms that are not in plain and intelligible language.

The guidance follows several undertakings obtained in late 2011 and early 2012 from firms in relation to insurance products. Senior management figures at the FSA, who will in due course assume responsibility for the consumer protection remit of the FCA, have indicated an intention to become more proactively involved in the design, governance and distribution of retail products (see, for example, summary of Martin Wheatley's latest speech to the British Bankers Association in last week's FSA

Key issues

Update). This guidance is the latest in a series of indications of this approach being put into practice. New product intervention powers form a key plank of the expanded powers which, it is proposed, the FCA will inherit, under the Financial Services Bill, which is currently progressing through Parliament. Guidance such as this is likely to be intended to correspond with new powers such as these, and firms can expect the FSA and the FCA, now that explicit guidance exists, to seek to take tougher intervention and/or enforcement action where they perceive breaches of the Regulations in future.

http://www.fsa.gov.uk/pages/doing/regulated/uct/library/index.shtml

http://www.fsa.gov.uk/static/pubs/guidance/fg12_02.pdf

FSA issues guidance on counterparty credit risk management

The FSA has (on 31 January) issued finalised guidance in relation to counterparty credit risk management by central counterparties. The guidance follows the consultation process undertaken during July 2011 and focuses on the high level areas of risk management governance and counterparty credit risk control framework, initial margin models, variation margin calculation, default fund adequacy, stress testing, wrong way risk and concentration risk, collateral and validation and backtesting.

http://www.fsa.gov.uk/static/pubs/guidance/fg12-03.pdf

FSA issues guidance on regulation of credit unions in Northern Ireland

In advance of the date when it will assume responsibility for regulating credit unions in Northern Ireland (31 March 2012), the FSA has published a policy statement (PS11/18) (on 1 February, although the Policy Statement is dated December 2011). This follows responses to the joint consultation paper (CP11/17) issued by the FSA and HM Treasury in August 2011 (http://www.fsa.gov.uk/library/policy/cp/2011/11_17.shtml).

http://www.fsa.gov.uk/static/pubs/policy/ps11_18_newsletter.pdf

Hector Sants speaks on delivery of twin peaks regulation

Hector Sants has today (6 February) given a speech at the British Bankers Association setting out how the arrangements for and approaches to conduct and prudential regulation will change as the transfer of the FSA's responsibilities to the FCA and PRA approaches.

In a high-level overview of the changes proposed to be made which will be of particular interest to firms which will be subject to dual regulation, he set out that, until this transfer occurs, the existing ARROW risk mitigation programme will be split between the actions relevant to the functions of the Conduct Business Unit and Prudential Business Unit, the predecessor bodies set up within the FSA in preparation for de-merger. He confirmed that firms due to complete ARROW assessments prior to Spring 2013 will still be subject to supervisory review, but that the review will be conducted simultaneously by two teams, each assessing risks against their new regulatory objectives. A single report will be delivered to the board of the firm subject to assessment, divided into two sections. He made clear that the two teams may ask similar questions, but that these will be aimed at addressing different risks, that no consolidated list of action points will be produced for firms and that there will be no prioritisation between conduct and prudential risk.

Looking ahead beyond the transfer of responsibilities, he gave some detail as to the resourcing approach which will be adopted by the FCA and PRA. He set out that, whilst the PRA will continue the FSA practice of dedicated firm supervision, the FCA will adopt a more flexible approach, conserving more resources for thematic interventions and responses to unexpected events.

As the Financial Services Bill which will shape the powers and responsibilities of the FCA and PRA progresses, he has also encouraged the public and Parliament to embrace their new judgment based and forward looking approaches and not to apply the benefit of hindsight to decisions taken by them.

Finally, he acknowledged the significant work still to be done, identifying particular issues as: -

- recasting threshold conditions to achieve alignment with the twin peaks model;
- commencing work on a new operational platform;
- detailed design work on the framework to replace ARROW;
- development of detailed procedures to support the draft Memorandum of Understanding between the FCA and PRA;
- division of the rule book between the FCA and PRA;
- effectively equipping staff and ensuring the right mix of industry and regulatory experience.

http://www.fsa.gov.uk/library/communication/pr/2012/012.shtml

FSA gives its viewpoint on MiFID II

Hector Sants' address closely follows a speech by David Lawton, the FSA's Acting Director of Markets, at the British Bankers Association on 30 January, given indications of the FSA's broad objectives and plans in relation to the implementation of the second Markets in Financial Instruments Directive ("MiFID II").

Focusing on the key aims of MiFID II of fostering market integrity, delivering market stability and enhancing transparency whilst promoting liquidity, he set out the anticipated framework under which MiFID II will integrate with other ongoing changes, principally the changes proposed under the Market Abuse Regulation and the second Market Abuse Directive. Identifying key gaps and areas for refinement of the proposals as: -

- which steps should be taken to address attempted market manipulation, use of own capital by OTF operators;
- standardisation of equity post-trade data;
- access thresholds for third country firms

and acknowledging the role of ESMA in developing technical standards and guidance called on the industry to continue to engage with the process of change to continue to shape the processes and measures which will be put in place as the European legislative process continues.

http://www.fsa.gov.uk/portal/site/fsa/menuitem.10673aa85f4624c78853e132e11c01ca/?vgnextoid=e5287ea416f25310VgnVCM10000044bc10acRCRD&vgnextchannel=e17f60f62b415310VgnVCM10000044bc10acRCRD&vgnextfmt=default

FSA publishes review into sale and rent back

Further to a review of the sector commenced in March 2011, the FSA has (on 3 February) published a report showing that most sale and rent back transactions were "*either unaffordable or unsuitable and should never have been sold*". The report follows the FSA's assumption of responsibility for regulatory oversight of sale and rent back transactions in 2009, its implementation of a full regulatory regime in this area in June 2010 and subsequent agreements reached with firms for them to cease undertaking sale and rent back business and/or undertake past business reviews.

http://www.fsa.gov.uk/portal/site/fsa/menuitem.10673aa85f4624c78853e132e11c01ca/?vgnextoid=28a184b6dc935310VgnVCM2000004fbc10acRCRD&vgnextchannel=3b39e6ef1daf4310VgnVCM10000044bc10acRCRD&vgnextfmt=default

Research paper reports on consumer experience and perceptions of financial services regulation

The FSA has (on 2 February) published a research paper commissioned by it to measure consumers' experiences of financial services regulation, awareness of the FSA and perceptions and expectations of what a financial services regulator should do. The paper, which found, for example, that one third of respondents were aware of the FSA and that sixty per cent thought that the FSA regulates the financial services industry effectively, raises questions for the FSA and FCA to consider in the area of consumer engagement, such as suggesting the development of a strategy dealing with the extent to which the FCA wishes to develop a recognisable brand.
http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/consumer-research/crpr86.pdf

Authors

Roger Best
Partner

T: +44 20 7006 1640
E: roger.best
@cliffordchance.com

Mathew Newick
Partner

T: +44 20 7006 8942
E: mathew.newick
@cliffordchance.com

Martin Saunders
Partner

T: +44 20 7006 8630
E: martin.saunders
@cliffordchance.com

Carlos Conceicao
Partner

T: +44 20 7006 8281
E: carlos.conceicao
@cliffordchance.com

Luke Tolaini
Partner

T: +44 20 7006 4666
E: luke.tolaini
@cliffordchance.com

Chris Stott
Professional Support Lawyer

T: +44 20 7006 4231
E: chris.stott
@cliffordchance.com