

FSA Update

At the FSA last week: -

FSA and SEC co-ordinate to take action on conflict failures during the financial crisis

The FSA has (on 2 May) imposed a financial penalty of £3.5 million on **Martin Currie Investment Management Limited** and **Martin Currie Inc** (together "**Martin Currie**") for systems and controls failures relating to the identification and handling of conflicts of interest. In parallel action taken in relation to the same conduct (confirmed on 10 May) the US Securities and Exchange Commission ("**SEC**") has imposed a financial penalty of \$8.3 million. The SEC's investigation is continuing.

Both sets of regulatory action relate to an investment by one client ("**Client 1**") of approximately £15 million in an unlisted bond issued by an offshore Chinese firm, and associated transactions, managed from Martin Currie's Shanghai office.

The FSA and the SEC found that the investment resulted in a loss incurred by Client 1, but had significant advantages for another client ("**Client 2**"), which used the proceeds of the bond issue to repay a large proportion of illiquid investments. This alleviated liquidity problems then faced by Client 2, which largely resulted from an increased number of redemption requests from investors during the financial crisis. The FSA and SEC found that the alleviation of these liquidity problems benefited Martin

Currie by helping it to avoid reputational damage which could have arisen had those liquidity problems led to an inability by Client 2 to meet investors' pending redemption requests.

The FSA found that the delay of over one year in identifying the conflict of interest and Martin Currie's subsequent handling of the conflict breached Principles 2 (skill, care and diligence), 3 (management and control) and 8 (conflicts of interest) of its Principles for Businesses ("**the Principles**") and associated rules contained in its Senior Management Systems and Controls ("**SYSC**") and Conduct of Business ("**COB**") sourcebooks. The SEC found that the conduct contravened antifraud, affiliated transaction, reporting and compliance provisions of US federal laws.

The financial penalty imposed by the FSA was reduced by 30 per cent for settlement at stage one of its executive settlement procedures. As is common when entering into settlements such as that agreed with the SEC in this case, Martin Currie neither admitted nor denied the SEC's findings. Both regulators acknowledged the co-operation provided and remedial steps implemented by Martin Currie, which have included prompt notification once it became aware of the issues, a detailed investigation, payment of compensation to Client 1, disciplinary action against some individuals involved and improvements to its governance structure and risk control processes.

The penalty imposed by the FSA is the largest it has imposed in connection with breaches of conflict of interest rules. The case is also significant as an example of close trans-Atlantic co-operation aimed at tackling breaches occurring against the backdrop of the global financial crisis.

The FSA makes clear (at paragraph 2.15 of its Enforcement Guide and paragraphs 6.2.19G to 6.2.27G of its Decision Procedure and Penalties Manual ("**DEPP**")) that it may take action in parallel with other authorities. However, it has only done so on relatively few occasions to date. Similarly, by comparison to the SEC

Key issues

- FSA and SEC co-ordinate to take action on conflict failures during the financial crisis
- FSA takes action against firm and former executive chairman for corporate governance issues
- FSA fines and bans broker for insurance fraud
- Insider dealing proceeds confiscated from Rupinder Sidhu
- FSA issues warning to customers of Castle Personal Insurance Brokers Limited
- High Court declares that failure to obtain FSA's prior consent does not invalidate appointment of administrators
- FSA publishes Recovery and Resolution Plan update

In particular, the number of FSA enforcement cases concerned with firms' and individuals' responses to the crisis has been relatively small. As we emerge from the financial crisis, and as the FSA and other regulators continue to place particular emphasis on the responsibilities of both firms and individuals for corporate governance and effective senior management oversight, it will be instructive to note whether more multi-agency investigations into conduct during the crisis mature into enforcement action.

<http://www.fsa.gov.uk/static/pubs/final/martin-currie.pdf>

<http://www.sec.gov/news/press/2012/2012-90.htm>

FSA takes action against firm and former executive chairman for corporate governance issues

The FSA has (on 8 May) fined **Mitsui Sumitomo Insurance Company (Europe) Limited ("MSIE")** £3.345 million for failures in corporate governance relating to its expansion into non-Japanese markets between October 2009 and March 2011. It has (also on 8 May) fined its former executive chairman Mr **Yohichi Kumagai** £119,303 and has banned him from performing any significant influence controlled function in future. Both fines were reduced by 30 per cent as MSIE and Mr Kumagai settled at stage one of the FSA's executive settlement procedures.

MSIE was found by the FSA to have breached Principle 3 (management and control) of the Principles. Mr Kumagai was found to have breached Principles 5 (significant influence functions: management and control) and 7 (significant influence functions:

regulatory compliance) of the FSA's Statements of Principle for Approved Persons ("**APER**"). Specifically, the FSA found that MSIE and Mr Kumagai failed to: -

- take prompt and effective action to ensure that appropriate governance and control arrangements were in place across its business;
- ensure that key posts were filled with staff with the necessary experience, skills, knowledge and time to fulfil the requirements of those roles;
- ensure the effective and timely implementation of a new IT administration system which would have provided better management information;
- rectify weaknesses in branch oversight, reserving and aggregate management processes.

The action taken by the FSA followed a review commissioned by MSIE's holding company in 2011 into concerns identified by the FSA arising from an earlier ARROW visit. The case marks the first use by the FSA of its "new" penalty regime under Chapter 6 of DEPP in a case where it has taken action against a large firm for systems and controls failures. Although the conduct in respect of which the action was taken occurred partially before that regime came into force in March 2010, the FSA decided to use the five stage procedure as the gravamen of the breach occurred after that time. The FSA assessed the seriousness of the breaches at level four (of five) of its sliding scale for both MSIE and Mr Kumagai. When taking action, the FSA recognised the co-operative and constructive steps taken by MSIE, Mr Kumagai (who voluntarily resigned from his post at

an early stage) and MSIE's holding and parent companies during its investigation.

<http://www.fsa.gov.uk/static/pubs/final/msicel.pdf>

<http://www.fsa.gov.uk/static/pubs/final/yohichi-kumagai.pdf>

FSA fines and bans broker for insurance fraud

The FSA has (in a Final Notice dated 9 February, released on 10 May) fined **Donald McKee Morgan** £335,204 and has banned him from performing any function in relation to regulated activities. The FSA found that fraud had been committed between approximately 2005 and 2010 by the deliberate retention by Mr Morgan of premium payments which should have been paid to insurers by his firm. It found that his conduct in doing so and falsifying documents breached Principle 1 (integrity) of APER. The financial penalty is composed of a punitive element of £112,700 (reduced by 30 per cent as Mr Morgan agreed to settle at stage one of the FSA's executive settlement procedures) and disgorgement of financial benefit of £222,504.

Mr Morgan's wife **Janet Morgan**, who was the only other partner in the firm concerned, has (also by way of a final notice dated 9 February, released on 10 May) been publicly censured and banned from performing any function in relation to regulated activities. Specifically, the FSA found that her lack of awareness of and inaction in respect of Mr Morgan's conduct led her to breach Principle 6 (due skill care and attention in performance of significant influence functions) of APER.

<http://www.fsa.gov.uk/static/pubs/final/donald-morgan.pdf>

<http://www.fsa.gov.uk/static/pubs/final/janet-morgan.pdf>

Other Enforcement Notices

The FSA has (on 10 May) cancelled the Part IV permissions of **Mortgages UK 1970** and **Paulo Monteiro trading as Bunn & Co** following failures to submit Retail Mediation Activity Returns.

On 9 May, it cancelled the registration granted to **Syed Zaidi** as a small payment institution under Payment Services Regulations 2009 following a failure to pay fees and levies.

In a decision notices date 20 January 2012, released on 10 May, the FSA has set out its decision to refuse an application made by **Scott Briscoe Limited ("Scott Briscoe")** for **Mr Sidney Cordle** to perform the CF1 (director), CF10 (compliance oversight), CF11 (money laundering reporting officer) and CF30 (customer) controlled functions. The FSA has based its decision upon its finding that he had failed to disclose in his application a previous investigation of which he was aware, conducted by a network for which Scott Briscoe was an appointed representative. In a separate decision notice issued to Scott Briscoe, the FSA has set out its decision to cancel the firm's Part IV permission. Scott Briscoe and Mr Cordle have referred the FSA's decisions to the Upper Tribunal.

<http://www.fsa.gov.uk/static/pubs/final/mortgages-uk.pdf>

<http://www.fsa.gov.uk/static/pubs/final/paulo-monteiro.pdf>

<http://www.fsa.gov.uk/static/pubs/final/syed-zaidi.pdf>

<http://www.fsa.gov.uk/static/pubs/decisions/scott-briscoe-limited.pdf>

<http://www.fsa.gov.uk/static/pubs/decisions/sidney-cordle.pdf>

Insider dealing proceeds confiscated from Rupinder Sidhu

Mr Rupinder Sidhu, who was convicted of 22 counts of insider dealing in December 2011, has (on 8 May) been ordered to pay £572,283.21. The confiscation order requires Mr Sidhu to make payment within 28 days, in default of which an additional five years' imprisonment will be added to the two year sentence he has already received.

The confiscation order, made under Proceeds of Crime Act 2002 ("POCA"), seeks to recover his "benefit" from insider dealing. Under the punitive provisions of POCA, "benefit" is defined more widely than simply the profit made by Mr Sidhu, which, the FSA has stated in a previous press release, is estimated to have been approximately £524,000.

The prosecution of Mr Sidhu was the first where the FSA used its powers to enter into plea discussions with co-operating defendants under section 73 of the Serious Organised Crime and Police Act 2005. Mr Anjam Ahmad, who had been involved in the insider dealing activity with Mr Sidhu, pleaded guilty and gave evidence against him. In June 2011, Mr Ahmad received a suspended sentence of two years, was required to complete 300 hours of unpaid community work, and was fined £50,000 (in addition to a confiscation order of £106,280 and a regulatory financial penalty of £131,000).

<http://www.fsa.gov.uk/library/communication/pr/2012/050.shtml>

<http://www.fsa.gov.uk/library/communication/pr/2011/114.shtml>

FSA issues warning to customers of Castle Personal Insurance Brokers Limited

The FSA has (on 9 May) warned customers of **Castle Personal Insurance Brokers Limited ("Castle")** that the firm has entered administration. The FSA's brief statement states that it appears that Castle may have sold insurance to customers without passing premium payments to insurers.

<http://www.fsa.gov.uk/consumerinformation/firmnews/2012/castle.shtml>

High Court declares that failure to obtain FSA's prior consent does not invalidate appointment of administrators

In a judgment handed down on 3 May, Mr Justice Arnold has clarified the application of section 362A of the Financial Services and Markets Act 2000 ("FSMA"). Specifically, he has ruled that, when an authorised firm enters administration, a failure by the firm to obtain the FSA's prior consent to the appointment of administrators does not render those appointments invalid, provided that its subsequent consent is obtained.

In an application which was not contested by the FSA, he also declared that, in such circumstances, the appointment of administrators takes effect from the date when the FSA's consent is filed at Court.

Case details: *In the matter of Ceart Risk Services Limited* [2012] EWHC 1178 (Ch)

FSA publishes Recovery and Resolution Plan update

The FSA has (on 10 May) published a feedback statement (FS12/1) setting out core rules on recovery and resolution plans. The publication of final rules on "living wills", which affect firms with assets of over £15 billion, has been delayed until autumn 2012 pending a number of European and other international developments.

<http://www.fsa.gov.uk/library/policy/dp/2012/fs12-01>.

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