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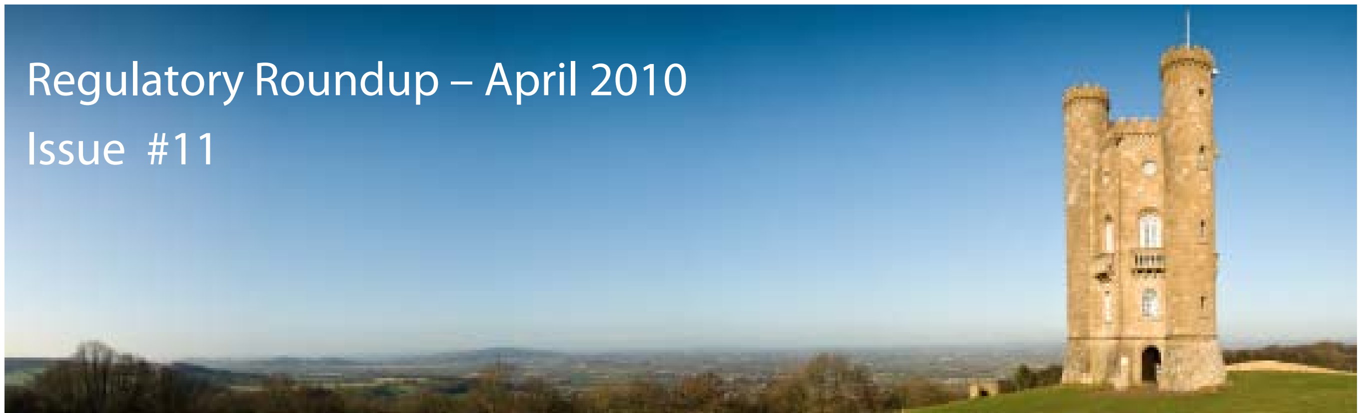

Regulatory Roundup – April 2010

Issue #11

In Brief:

Mobile Phones: CP on removing the exemption

Insider Dealing: FSA busts insider dealing ring, then charges 7 more

Fund Management Industry: Dan Waters gave a speech

Transaction Reporting: MarketWatch 34 published by the FSA

Financial Services Bill: A new financial stability objective for the FSA

US Investment Advisors: Private Fund Investment Advisers Registration Act 2010

CASS: FSA release CP 10/9

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If any of the topics discussed above raise questions or a need for guidance or support, please feel free to contact Peter Carlisle.

apcc

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aima

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Useful link:
[CP10 07]

As you will know, the obligation to record telephone conversations and electronic communications (as set out in COBS 11.8) does not currently extend to "telephone conversations and electronic communications (except emails) made with, sent from or received on a mobile telephone or other mobile handheld electronic communication device". The exclusion was primarily based upon concerns that the then technology was not sufficiently developed to be able to capture such communications.

The FSA has published CP10/7 - "Taping: Removing the mobile phone exemption" – in which, as the title suggests, it is proposed to remove this exemption. It's interesting to note from the paper that whilst the FSA surveyed 675 randomly selected firms, only 110 firms responded and of those 18 were scrubbed for not providing key information. However based upon the survey, with the additional benefit of an independently commissioned consultation, the paper assumes that after allowing for those firms putting a ban on their use, around 16,000 mobile phones will be affected by the new rules. Although there are differences in the estimated costs between the FSA survey and the separate consultation, the former shows an average one-off cost per user of £700 and on-going costs of £1,200 p.a.

The table on page 7 of the CP provides a handy reminder of the scope of the proposed application of the rules.

For the avoidance of doubt, the exemption available to a discretionary investment manager (COBS 11.8.6(2)) remains (as well as the 'infrequent basis' rule). However do bear in mind that this is an FSA rule and not an obligatory EU-wide rule. As such, any discretionary investment manager hoping to take advantage of the exemption cannot assume that non-UK investment firms are subject to a recording obligation.

Note from the draft rules that whilst the recording obligation relates to equipment provided by or permitted by a firm, a new rule will be inserted to oblige a firm to prevent the use of private electronic equipment which the firm is unable to record or copy.

The consultation period ends 14 June. Should the proposals go ahead then the new rules should come into force in Q42010, subject to a transitional period of around a year.

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Insider Dealing

Useful links:

[FSA Press Release 1]

& [FSA Press Release 2]

If you are looking for Market Abuse Training, please speak to our Head of Training:

[Philip Chapman]

It will not have escaped your attention that FSA and SOCA have carried out a joint operation involving address searches and arrests in a clampdown on insider dealing; firms such as Exane, Novum, Deutsche Bank and Moore Capital have been named.

Although not official policy, in the real world it is likely that individuals taking advantage of inside knowledge will always be with us (shoplifting is a criminal offence; stores have camera surveillance and security staff and yet 'shrinkage' in the UK stands at around £4.9bn http://news.bbc.co.uk/1/hi/8347222.stm). Despite this, and given that market abuse features high on the FSA agenda (e.g. it is referenced in the FSA's Financial Risk Outlook and Business Plan), we suggest that firms give consideration to reviewing their current market abuse procedures and policies. Even if it is felt that these are already adequate, a review would demonstrate to the regulator that the firm is proactive in the area of market abuse.

The press release is very useful for those responsible for market abuse training within firms. The editor's notes contain in one place access to all the FSA insider dealing prosecutions/pending prosecution cases, the details of which can be used in training sessions as 'real life case examples'.

Further to this, the FSA charged seven more individuals with 13 charges in respect of conspiracy to deal on inside information obtained by the defendants from two major investment banks.

One defendant has additionally been charged with an offence in relation to money laundering. A warrant for the arrest of another person in connection with this investigation has been issued. The charges are based on allegations that cover a two-year-period and involve alleged unlawful profits of about £2.5 million.

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Useful link:
DW Speech

Dan Waters gave a speech the other day at the Institute of Economic Affairs on "The Future of the Fund Management Industry".

Nothing new of note was said but he did take the opportunity to reference the four priority risks highlighted in the Asset Management Sector Digest 2010 (see Regulatory Roundup 12 March). In addition to the concern that firms are failing to comply with the basic requirements for the protection of client assets and money, mention was again made of the need for robust valuation processes to ensure accurate fund valuations, whether they are authorised or unauthorised. The FSA continues to have concerns over the reliability of valuations - an example was shown in the Digest (q.v.) – and it is to be noted that the "asset management sector team is working closely with the supervision line to ensure this issue remains in the forefront of fund managers' minds". No Dan Waters speech would be complete without some reference to the AIFM Directive. We are reminded that a key area are the proposals on the marketing of, or investment in, third country funds. Worst hit would be where both the fund and the fund manager are based outside Europe; in the absence of any jurisdiction equivalence not only would marketing not be permitted but even an 'own initiative' investment by an investor would not be permitted.

Useful links:
Swift

Market Watch Issue 34

All Implementation

Market Watch No 34 has been published by the FSA.

An interesting article tucked away on page 2 advises that transaction reporting firms need a BIC code. Some firms will already have one but if this is not the case with your firm, and you transaction report, then you will need to apply to SWIFT for a BIC. Once obtained, the BIC must be advised to the FSA's transaction monitoring unit. Please see the article for further details.

Elsewhere it is confirmed that the alternative instrument identifier (AII) implementation project has been delayed (again). Until it is up and running firms are not obliged to report securities derivatives transacted on regulated markets that do not use an ISIN (non-securities derivatives do not need to be reported).

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Useful link:
[FS Bill 2010]

The Financial Services Bill had its second reading in the House of Lords on 15 March 2010.

The Bill's many sections detail a new financial stability objective for the FSA, allow the FSA to prohibit or require disclosure of short selling, and strengthen disciplinary powers for the FSA, amongst other changes. The proposals widen the FSA's authority to prohibit short selling by removing an existing link that restricts the power of prohibition to cases of possible market abuse. In relation to strengthened disciplinary powers the Bill provides the FSA the ability to impose penalties on a person who has performed a controlled function without approval and also the capability to suspend individuals and firms for a set period as a disciplinary outcome. Punishment is not the only area of gain - the FSA will have more authority to gather information and will be required to create remuneration policy rules for regulated firms.

Useful link:
[IMC Link]

If your firm has set the Investment Management Certificate as an exam determinant in connection with SYSC 5.1 ("A firm must employ personnel with the skills ..." etc.) then a reminder that there are changes in hand (of course, if you are a retail firm then TC App 1.1 will determine for which activities an exam is required). The result is that if any persons are planning to take the IMC then they will *either* have to complete it before the end of this August *or* wait until 1 September when a new syllabus applies. The changes come about as a result of the Retail Distribution Review. Note that the changes will apply regardless of whether or not your firm deals with retail clients.

The link, left, will take you to the CFA website which in turn has a pdf attachment which explains what is happening in greater detail.

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Useful link:
[CASS CP10 9]

The FSA has released Consultation paper CP10/9 – "Enhancing the Client Assets Sourcebook".

Proposals include greater transparency requirements by UK authorised prime brokers ('PBs') in respect of re-hypothecation provisions by way of a summary annex (the CP refers to "... sophisticated clients' lack of understanding ..."). Additionally PBs will have to offer clients a daily statement detailing the assets and monies held; the location of safe custody assets; and a list of institutions where client money is held. Other proposals include a restriction on the amount of client monies that can be held in client money bank accounts within a group. We also see the introduction of yet another new Controlled Function: CF10A, the CASS oversight function. However for firms holding less that £1m client money/£10m safe custody assets it will be deemed that a person approved to perform a governing function (for this purpose this means CF1 or CF3 or CF4) and who is also appointed to carry out the CASS oversight function will not have to be specifically approved for the latter. In recognition of the importance that the FSA is now placing on client assets there will be a new return that will need to be submitted to the FSA (see Annex 4 of the CP for an example). Should the proposals go ahead the relevant changes to the FSA Handbook will be phased in in 2010 and 2011.

The consultation period ends 30 June.

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Useful links:

Dodd Amendment

15MarchProposal

HR4173

There have been further developments in respect of the proposed Private Fund Investment Advisers Registration Act 2010 (see Regulatory Roundup 18 January and previous). Senator Christopher Dodd's financial reform proposals passed the Senate Committee on Banking on 23 March with a 13-10 vote, without a single Republican voting for it. Although Dodd had released his 'Senate Proposal' on 15 March, he introduced a manager's amendment before the 13-10 vote was made– see the first link, left. Amongst the changes this time is a change in the definition of a 'foreign private advisor' ('FPA') as compared with HR 4173, the Wall Street Reform and Consumer Protection Act 2009, which was passed in the House of Representatives on 11 December 2009. (See the Regulatory Roundup of 18 January)

The 15 March Senate proposal removed from the FPA definition the '12 month' time period as in 'during the preceding 12 months: has had fewer than 15 clients, etc...'. This suggests that the definition of a 'foreign private adviser' will now depend on criteria in the present only. In addition the change in criteria for a FPA of having less than $25m AUM attributable to US clients now, after the manager's amendments, refers to US clients and US investors.

To appreciate the 'current version' of the proposal we suggest you look to pages 18 & 19 of the first link ('Amendment') which contains all the late amendments and use this as a reference when looking at the proposals contained within pages 365 to 383 of the second link ('15MarchProposal'). The third link is HR 4173, the document which passed through the House of Representatives, and can be used as a comparison.

Other Dodd amendments to the 15 March Senate Proposal included preventing the SEC defining the word 'client' to extend to an investor in a private fund managed by an investment advisor, if such private fund has entered into an advisory contract with such adviser. However, this definition of client is limited to apply only for the purposes of sections 206(1) and 206(2) of the Investment Advisers Act 1940, the antifraud provisions of the act. It remains unclear which definition is applicable when considering the '15 clients' provision, although the reference mentioned above to 'clients in the US and investors in the US' does suggest that 'client' could well mean fund.

It is expected that the final version of the 'Restoring American Financial Stability Act' will be much more business friendly to win over Senator Richard Shelby, the banking panel's top Republican. Although Republicans do want a bill this year, without their support the bill would struggle to pass the Senate floor, which could happen as early as mid April.

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Peter Carlisle

Or for details of any other of Complyport's services, please contact Philip Chapman

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