



Regulatory Roundup

15 May 2012

Issue 40



In Brief:

Exchange Traded Products: FSA issues factsheet on key features and risks

Corporate Governance: Hector Sants: Outgoing CEO sets out expectations for good corporate governance

Corporate Governance: Mitsui: Failings led to £3.345M financial penalty

Training and Competence: Proposed changes to TC include addition of 3 new 'appropriate' qualifications

Cold-Shouldering: Reminder for firms to make approved persons aware of cold-shouldering cases

Recovery and Resolution Plans Update: FSA issues Feedback Statement and FAQs

Currie Conflicts: FSA fines Martin Currie £3.5M for failing to properly manage a conflict of interest

In the Complyport Regulatory Roundup:

| | |
|---------------------------------------------|--------------------------|
| <i>Exchange Traded Products</i> | <u>2</u> |
| <i>Corporate Governance: Hector Sants</i> | <u>2</u> |
| <i>Corporate Governance: Mitsui</i> | <u>3</u> |
| <i>Training and Competence</i> | <u>5</u> |
| <i>Cold-Shouldering</i> | <u>6</u> |
| <i>Recovery and Resolution Plans Update</i> | <u>6</u> |
| <i>Currie Conflicts</i> | <u>7</u> |
| <i>Regulatory Roundup Archive</i> | <u>8</u> |



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

Exchange Traded Products

Corporate Governance: Hector Sants



Useful links:

[ETP Factsheet](#)

[Regulatory Roundup 39](#)

[ESMA CP](#)

Amongst the 15 broad risk categories set out in the FSA's 'Conduct Risk Outlook 2012' (see Regulatory Roundup 39 for a link to this document) are Exchange Traded Products (ETPs), of which Exchange Traded Funds are a subset.

Over the last 18 months the FSA has conducted thematic visits to a number of providers who account for over 70% of the EU market. We are advised that the Regulator found some evidence of poor practice and firms have been asked to address risks where issues have been found.

In order to raise awareness of the key features and risks that the FSA considers important, it has issued a factsheet for investment advisers. Readers are made aware of the consultation paper issued by ESMA in January of this year on the regulatory framework for ETFs which may eventually result in changes to the factsheet. (Please note, it appears that links to the ESMA website do not open on some web platforms. If you cannot access the document using the link please copy and paste the following address into your browser: http://www.esma.europa.eu/system/files/2012-44_0.pdf).

Useful links:

[Hector's Speech](#)

[Regulatory Roundup 22](#)

Hector Sants, in his last speech as CEO of the FSA, focussed on the importance of corporate governance.

Firms – and particularly those that have been subject to an ARROW visit - will be aware that this is an area of interest to the FSA (see, for example, Regulatory Roundup 22, in which it is revealed that the Regulator was giving a double weighting to this area in the ARROW risk elements) and that it continues to believe that good governance increases the probability that good decisions will be made.

The speech set out **five key indicators** relevant to firms that failed during the financial crisis, including a dominating CEO and a dysfunctional board. Mr Sants also highlighted **three key components of effective corporate governance**: the board having a full understanding of the business model and associated risks, and being able to provide effective challenge; the Chairman's role in constructing and managing a board that has appropriate skills and experience; and for the board to have management information that relates to the firm's strategic plan so that it can ensure the execution of that plan.

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Corporate Governance: Hector Sants (cont.)

Corporate Governance: Mitsui



Useful links:

[Regulatory Roundup 3](#)

As for technical competence and general suitability, the FSA is “still surprised” by the number of times firms put forward **candidates** for approval that “**are not the right individuals for the role**”. As will be known (e.g. see Regulatory Roundup 3), the FSA has taken a more intrusive approach in the approval of significant influence functions (SIFs), which are basically all the CFs bar the CF30 customer function, including interviewing candidates. We are advised that over the last two years the FSA has determined **653 applications** following one or more SIF interviews. Of these, **48 were withdrawn**; **39** of which were due to **serious concerns** identified by the FSA. The speech set out four common examples of shortcomings seen in applicants. The **focus** of SIF interviews will include the **Chairman, CEO** and the **finance director** with the need to interview other individuals “judged on a firm-specific basis”. We are told that these principles will be carried forward to the new regulatory regime.

The speech concluded with a new expression to add to the likes of ‘credible deterrent’ and ‘be afraid, be very afraid of the FSA’; ‘**constructive tension**’. The latter is to express the relationship between the FSA and firms (and replaces ‘working together in partnership’).

Useful links:

[Final Notice: Mitsui](#)

Only a matter of days after Hector Sants’ speech on corporate governance (see above article) the FSA published Final Notices relating to corporate governance failings by Mitsui Sumitomo Insurance Company (Europe) Ltd (Mitsui).

Whilst Mitsui may be an insurance company and part of one of the world’s largest non-life insurance groups, the issues that led to enforcement action are relevant to all firms. The key regulatory provision in the Final Notice was a **failure of Principle 3** “A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”; there was no customer loss as such and it is acknowledged that Mitsui did not financially benefit from the breach.

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Useful links:

[Final Notice: Kumagai](#)

[Regulatory Roundup 39](#)

It is interesting that the summary references the importance of adequate management information; the need to have senior management with the necessary skills; and for the board having a full understanding of the business model – reflecting the **three key components of effective corporate governance** highlighted in the speech by Mr Sants.

A previous ARROW visit had also commented upon the need to appoint a suitably experienced independent Non-Executive Director (NED) - Regulatory Roundup 39 contains a link to the FSA's guidance on its expectations of NEDs.

For a three month period the firm also failed to hold sufficient capital to meet its Individual Capital Guidance, which in itself could have constituted a breach of Threshold Condition 4 and of GENPRU 1.2.26R.

For its failings Mitsui was subject to a **financial penalty of £3.345M**.

The pain didn't stop there as Mitsui's **Chief Executive**, Mr Yohichi Kumagai, incurred a **financial penalty of £119,303** and was also subject to a **Prohibition Order** (which basically prevents him from performing just about any Controlled Function) for failing to ensure adequate corporate governance and control arrangements were in place. This acts as a reminder that whilst the Handbook contains the 11 Principles (**PRIN**) applicable to all **firms**, it also contains the sometimes lesser known Principles and Code of Practice (**APER**) which is applicable to **approved persons**.

Tracey McDermott, acting FSA Director of Enforcement and Financial Crime, was, following issuance of the Final Notices, quoted as saying "If those who hold senior positions in financial services firms had had any doubt about how seriously we view their regulatory responsibilities this fine and ban should make our position clear".



Useful links:

[CP12/8](#)

The publication CP12/8 ‘Changes to the Training and Competence Sourcebook’ proposes to add three qualifications to the ‘appropriate qualifications tables’ in the Training and Competence (TC) sourcebook as well as amending details for three qualifications.

As far as designated investment business is concerned, TC is only applicable to relevant activities carried on for a **retail client** (the full table of activities can be found in TC App 1.1). Having said that, SYSC 5 (‘Skills, knowledge and expertise’) is applicable to **all** investment firms **regardless of client base**.

The basic premise of SYSC 5.1.1 (‘**competent employees rule**’) is that firms must “employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them” (see also the article in this issue on ‘Corporate Governance’). SYSC 5.1.4A informs us that **firms that are not subject to TC** may wish to **take TC into account** when complying with the competence requirements in SYSC. In addition SYSC 5.1.5A tells us that where a firm is not subject to TC, but nevertheless requires employees to pass a relevant examination, then the FSA will take that into account when assessing whether the firm has ensured that the employee satisfies the knowledge component of the ‘competent employees rule’.

The changes are relevant to the activities: ‘managing investments’; ‘advising on securities’; ‘advising on, and dealing in, securities’; ‘advising on derivatives’; ‘advising on and dealing with or for clients in derivatives;’ and ‘advising on packaged products’.

The proposed changes to TC can be found in Appendix 1 of CP12/8.

Comments are invited by 31 May which, interestingly, is the same day as the proposed rules are due to come into force according to Appendix 1.



Cold-Shouldering

Recovery and Resolution Plans Update



Useful links:

[Regulatory Roundup 30](#)

[Takeover Panel: Cold-shouldering](#)

[FSA Dear CO Letter](#)

Around this time last year the FSA sent out a ‘Dear Compliance Officer’ letter concerning the ‘cold-shouldering’ imposed on three individuals by the Panel on Takeovers and Mergers (see Regulatory Roundup 30).

This article is to remind firms that that the letter contained a request from the FSA: “We expect authorised firms to remind all approved persons at their firms about the ‘cold shouldering’ of Myerson, Padgett and Posen and of the provisions of MAR 4.3 at regular intervals for the three years that the Panel’s finding remains effective”.

Further details of the case, and of ‘cold-shouldering’, can be found in Regulatory Roundup 30.

Useful links:

[Regulatory Roundup 34](#)

[Regulatory Roundup 39](#)

[RRP Feedback Statement](#)

[RRP Information Pack](#)

[FAQs](#)

Regulatory Roundup 34 contained details of the FSA proposals for ‘recovery and resolution plans’ (RRP) (CP11/16).

All firms subject to CASS 6 and/or CASS 7 (client assets/client money) are required to draw up a **CASS resolution pack**. The Rules relating to this come into force in October and further details can be found in Regulatory Roundup 39.

The major part of CP11/16 was relevant to **UK deposit takers** and **BIPRU 730K firms** with gross assets exceeding £15bn. Such firms will be required to maintain ‘recovery plans’ (identifying options to recover financial strength and viability should a firm come under severe stress) and ‘resolutions packs’ (containing detailed information about the business and operational structure). In the light of various developments the FSA has decided to delay publication of the final rules and has therefore issued a Feedback Statement (FS12/1) and FAQs. The final rules “will be published no later than autumn 2012”.

The FSA intends to consult at a later date on applying RRP rules to the UK branches of non-EEA firms without UK subsidiaries.





Useful links:

[Final Notice](#)

[SEC Action](#)

A Final Notice reveals that the FSA has fined Martin Currie Investment Management Ltd (MCIML) and Martin Currie Inc (MCI - together Martin Currie) for failing to properly manage a conflict of interest. Both MCIML and MCI's UK branches are FSA authorised and are both registered with the SEC as investment advisers.

The matter concerns two funds which the FSA refers to as "Fund A" and "Fund B" (or which the SEC refers to as the Martin Currie China Hedge Fund LP and its U.S. registered investment company client The China Fund Inc).

In brief, "Fund B" invested £15M in an unlisted bond, which halved in value over the next two years. On the other hand, "Fund A" was having liquidity problems due in part to its exposure to illiquid investments. It transpired that of the proceeds of Fund B's investment in the bond, half of the proceeds were used to repay these illiquid investments which helped alleviate Fund A's liquidity problems.

The firm was subject to a financial penalty of **£3.5M**. Under separate action by the **SEC**, Martin Currie has been fined **\$8.3M**.





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[Past issues](#)

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