



Regulatory Roundup – 26 February 2010 Issue # 9



FATF

It may be recalled that the Financial Action Task Force (FATF) used to maintain a list of 'Non-Cooperative Countries and Territories' – a total of 23 countries/territories appeared on the list at one time or another. As and when a listed entrant made significant progress in addressing AML/CFT deficiencies it was removed from the list; the last country was removed in October 2006.

In April of last year the G20 Leaders asked FATF to 'revise and reinvigorate' the review process for assessing compliance by jurisdictions with AML/CFT standards.

In response, FATF has produced not one but two documents.

The first one is a 'Public Statement' which identifies those jurisdictions with such deficiencies, ranging from the likes of Pakistan, where some effort has been made, to Iran where FATF will consider calling for a strengthening of counter-measures in June of this year if no steps are taken by that country to improve its AML/CFT regime. Paul Vlaanderen, FATF president, stressed that this is not simply a 'one-off' blacklist but rather 'an evolving product' with countries leaving the list and countries entering the list as the review process progresses.

The second document contains a list of jurisdictions ranging from Greece to Qatar where there are also deficiencies but where FATF has been provided with a written high-level political commitment to address the identified deficiencies.

Firms will need to bear in mind these lists when considering, and providing internal reports on, their AML/CFT obligations.

<http://www.fatf-gafi.org/dataoecd/34/29/44636171.pdf>

<http://www.fatf-gafi.org/dataoecd/34/28/44636196.pdf>

http://www.fatf-gafi.org/document/0/0,3343,en_32250379_32236879_44228352_1_1_1_1,00.html



Out of Control

A brief press release by the FSA announced that it had successfully brought its second prosecution for change in control offences. Semperian pleaded guilty to acquiring an interest in an authorised firm before receiving approval from the FSA (SUP 11 refers). Semperian's fine of £1,000 contrasts with last year's action against the sole director of mortgage broker Exetra for change of control offences; there the fine was £3,000. More interesting is reading alternative press accounts of the Semperian case which put a different spin on the FSA's victory.

According to these articles the FSA dropped charges against two other Semperian entities and Semperian's chief executive – with the FSA agreeing to pay legal costs. The magistrate is quoted as saying that rather than Semperian undermining the regulatory system by not obtaining prior approval, the FSA was doing a good job of undermining itself by only bringing two prosecutions against the hundreds of companies that have failed to get approval before takeovers.

Note that due to the date that the offence was committed the maximum fine that could have been imposed was £5,000. However since March of last year the courts now have the power to impose an unlimited fine.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/030.shtml>

<http://www.estategazette.com/blogs/property-law/2010/02/chief-exec-of-property-fund-off-the-fsa-hook.html>

<http://www.propertyweek.com/story.asp?sectioncode=297&storycode=3158354>

Broken

Two brokers, Wills & Co and Direct Sharedeal ('DS'), both met with FSA actions in February and there has been a large amount of publicity about both cases. Common to both was unacceptable or high pressure sales tactics in respect of higher risk securities to clients (and numerologists will be interested to learn from the 19 page DS Final Notice that the FSA reviewed sales calls to 19 clients, whilst the 19 page Final Notice of Darren Lansdown of Wills & Co tells us that the FSA reviewed 19 transactions there).

A particularly novel sales tactic in the Wills & Co case was the reference to the COBS rule which recommends that customers should hold up to 10% of their investment portfolio in high risk securities. When challenged by the FSA in June of last year the firm admitted that they couldn't identify the rule (and nor could anyone else) but despite this Wills & Co continued to refer to this 'rule' even after June in correspondence with the FOS (section 4.36 of the Final Notice against Katharine Prichard refers). Of note to Compliance Officers: both the Compliance Director and the Sales Director received similar censure although the former will not hold a significant influence function for 5 years, compared to a 3 year period for the latter.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/031.shtml>

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/029.shtml>



AIFM (cont)

The Alternative Investment Fund Managers Directive proposal saga continues to rumble on (the original draft Directive was issued at the end of April last year). After the 'Swedish Proposal' we now have the 'Spanish Proposal'.

A quick recap on the *original* proposals:

- It would impact on all 'Alternative Investment Funds' which are basically all funds that are not harmonised under UCITS
- The Directive will capture all EU AIFMs with AUM above €100m (€500m where AIF with no leverage and a lock-in period of 5+ years)
- The AIFM will have to report to its regulators on areas such as principal exposures; risk concentrations; and performance data
- Minimum capital for an AIFM of €125K (and higher if AUM exceed €250m)
- Generally only funds domiciled in Europe can be marketed by an EU authorised AIFM
- Offshore funds can be marketed but only under an EU approved passport (and would not be in force until 3 years after the rest of the Directive)
- Such third party funds will need to comply with stringent requirements on regulation, supervision and cooperation
- AIFs can be marketed to retail within same territory but no passporting rights to other Member States
- Each AIF will need an EU credit institution as a depositary of the scheme's assets and cash

The Swedish presidency made various changes in a bid to reach a compromise, with the revised draft published in November. The general feeling was that this was an improvement, although they managed to slip in a completely new provision (Article 9a) on remuneration policies. The Spanish took over the presidency and issued its compromise draft this month which has received criticism from some areas, including the FSA.

It is reported that the European Parliament has in excess of 2,000 proposed amendments to review. Given this, and the continued opposition to some of the proposals (most notably from the UK), it may well be that we will see the first anniversary of the draft Directive's publication before any agreement is reached.

For those brave enough, below are links to the original draft (April 2009); the Swedish redraft (November



2009); and the Spanish compromise (February 2010).

[Fund managers proposal en.pdf](#)

<http://register.consilium.europa.eu/pdf/en/09/st15/st15910.en09.pdf>

<http://register.consilium.europa.eu/pdf/en/10/st05/st05918.en10.pdf>

Hedge Funds & Systemic Risk

Neatly following on from the latest developments in the ongoing AIFM saga is the publication by the FSA on 'Assessing possible sources of systemic risk from hedge funds'.

The FSA conducts two different surveys every six months: Hedge Funds as Counterparties Survey ("HFACS") - which has been running for 5 years; and Hedge Fund Survey ("HFS") - introduced for the first time last October. The publication sets out key findings – which is basically that hedge funds do not impose any material risk - based on surveys in October 2009.

The HFS survey took in 50 of the largest managers covering ('touching' is the expression used in the report) over \$300bn of hedge fund AUM, representing approximately 20% of the global market. The analysis shows that for the surveyed hedge funds: the average cash borrowing is 202% of net equity; the aggregate footprint was mostly below 3% for the majority of asset classes; and that the assets of the funds could be liquidated before their liabilities became due.

The HFACS survey looked at the counterparty risks between the funds and banks. The findings showed that the maximum potential credit exposure any one bank had to one hedge fund was less than \$500m and that the largest hedge fund in terms of aggregate credit exposure was just over \$1bn across a number of banks. In the opinion of the FSA these are manageable in the context of the overall credit risk and capital requirements of the banks.

The report references the much criticised Alternative Investment Fund Managers Directive with the FSA expressing the hope that this report, and the continuation of the surveys on a six monthly basis, contributes to the ongoing debate about the Directive.

The document is barely a dozen pages in length and is quite readable – see link below.

http://www.fsa.gov.uk/pubs/other/hedge_funds.pdf

Hedge Funds & Systemic Risk - Information Collection

With systemic risk and hedge funds in mind, the International Organization of Securities Commissions has released details of a template for the global collection of hedge fund information which it believes will assist in assessing possible systemic risks arising in this sector. Such a template will ensure consistency of information collection and exchange amongst regulators.

There are 11 proposed categories of information – see the attached for details.



Note that it is proposed that the first data gathering exercise could be carried out as early as September this year.

<http://www.iosco.org/news/pdf/IOSCONEWS179.pdf>

AIFM & FSA (cont)

And just to make the FSA's views clear, Dan Waters' speech the other day – which reminded us that the FSA regulates around 80% of the hedge fund management industry in Europe - made interesting reading. Following praise of sorts for the progress made on the proposed Directive under the Czech and Swedish presidencies, when making comments relating to the changes under the new Spanish presidency he has used 'unwelcome' three times. Dan Waters focuses in particular on third country funds and managers. Article 35 has been reinstated in the latest version, although with revised wordage. Under this, Member States can allow the marketing of non-EU established AIFs by non-EU AIFMs on their territory provided that certain requirements are met, including 'appropriate cooperation agreements' ensuring an efficient exchange of information being in place between the competent authorities of the AIFM and the Member State; the content of the cooperation agreements have not yet been defined.

The speech ends with reference to the FSA's report on hedge funds and systemic risk, which we commented upon above.

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0225_dw.shtml

If any of the topics discussed above raise questions or a need for guidance or support, please feel free to contact Peter Carlisle at peter.carlisle@complyport.co.uk

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COMPLYPORT
COMPLIANCE LEADERSHIP

Complyport Limited

4 Cavendish Square, London W1G 0PG

t: +44 (0) 20 7399 4980

f: +44 (0) 20 7629 8002

e: info@complyport.co.uk

w: www.complyport.co.uk

email.

Complyport Ltd. 4 Cavendish Square, London, W1G 0PG. Tel: +44 (0)20 7399 4980. www.complyport.com