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Briefing note

14 November 2011

FSA Update

At the FSA last week:

- **Market abuse: FSA imposes largest ever fine on an individual**

The FSA has fined Rameshkumar Goenka, a private investor based in Dubai, US$9,621,240 (approximately £6m), the largest financial penalty it has ever imposed on any individual, for market abuse connected with structured products held by him.

The penalty, which was reduced from $12,414,560 under the FSA's executive settlement procedures, related to the manipulation by Mr Goenka of the price of Reliance Industries securities ("**the Reliance Securities**"), which are listed on the London Stock Exchange as Global Depositary Receipts ("**GDR**s"), for the purposes of avoiding a significant loss under the terms of the structured product he held.

Mr Goenka ordered the placement, in rapid succession, of a series of substantial orders very shortly before the end of a closing auction on 18 October 2010 (the date of maturity of the structured product he held). By doing so, he ensured that the closing price of the Reliance Securities was above a predetermined level, thereby avoiding a loss of $3,103,640 under the terms of the structured product he held (and was overpaid in this sum by the counterparty bank).

The penalty imposed upon him was calculated under the FSA's 'new' penalties regime which has been in place since 6 March 2010 and provides for a five step approach to penalty-setting.

Under step 1 of this process he was ordered to repay the $3,103,610 which he wrongfully obtained from the counterparty bank under the FSA's powers to order restitution in market abuse cases (pursuant to section 384 FSMA).

It is, in some respects, surprising that, at step 2 of this regime, Mr Goenka's conduct, the deliberate, concerted and premeditated nature of which is emphasised in the Final Notice as an indicator of particular gravity, was only assessed at level 4 of the five point scale of seriousness. Assessing his conduct at level 5 would have increased the penalty by some $3m.

As it is, however, the penalty imposed on Mr Goenka far exceeds the previous highest fine imposed on an individual for market abuse (or indeed any other type of infringement). The penalty imposed is likely to have been higher (both in terms of the amount of restitution he would have been ordered to pay and the relevant multiplier for the purposes of calculating

Key issues

- Market abuse: FSA imposes largest ever fine on an individual
- FSA fines Coutts £6.3 million in relation to structured products
- Complaints Commissioner upholds actions of FSA in land-banking investigation
- FSA issues policy statement on RMAR data collection (PS11/13)
- FSA issues policy statement on product disclosure for retail products (PS11/14)
- FSA acts to safeguard ARM investors' funds
- Requirement to record mobile communications comes into force

the punitive element of the penalty) had Mr Goenka succeeded in his attempt to similarly manipulate the price of Gazprom GDRs in order to secure a significant payment (or avoid loss) under the terms of another structured product held by him. In the event, his attempts to do so were thwarted by other factors affecting the price of those securities, but his conduct in relation to those securities was taken into account by the FSA, as an aggravating feature, when calculating the level of the penalty imposed on him.

The FSA has clearly (correctly in our view) concluded that there is no such regulatory breach as 'attempted market abuse' (aside from breaches of APER 1 (integrity) or APER 3 (proper standards of market conduct) if the activity is by an approved person). This position looks set to change, as current drafts of the new Market Abuse Directive and Market Abuse Regulation seek explicitly to capture instances of attempted insider dealing or market manipulation.

It is notable that the very significant penalty was imposed in respect of the manipulation of the price of GDRs (and the collateral effect on the value of Mr Goenka's structured products). This contrasts with the more orthodox instances of market abuse in respect of which action has been taken to date, where individuals have benefited from the manipulation of the price of securities on the main list.

The FSA's decision to pass on disgorgement of the amount of the loss avoided by Mr Goenka to the counterparty of the structured product is also interesting. In doing so, it has combined its powers to impose a financial penalty under section 123 FSMA, and to order restitution to 'victims' of market abuse, under section 384 FSMA.

A similar flexibility of approach has been adopted in other recent market abuse cases with, for example, prohibitions imposed on approved persons and civil injunctive relief obtained against non-approved persons[1] and companies[2] in combination with financial penalties. To date, the FSA has stopped short of seeking to pursue those involved in market abuse through criminal enforcement channels.

How this approach continues to develop remains to be seen, and may well be seen in the context of the facts of this case. Several approved

[1] See, for example, http://www.fsa.gov.uk/pubs/final/michiel_visser.pdf and http://www.fsa.gov.uk/pubs/final/oluwole_fagbulu.pdf

[2] See http://www.fsa.gov.uk/pubs/final/samuel_nathan_kahn.pdf

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persons appear to have been involved in the manipulation of the price of the securities. It is highly likely that strong action is in the course of being taken, or will be taken against them (including, potentially, in relation to breaches of APER as outlined above), although the FSA has not yet confirmed whether or which such action is being taken.

A lingering question is why the FSA chose not to prosecute this case as a criminal offence under s.397 FSMA. Presumably the answer is that it went for pragmatic approach recognising the potential difficulties in extraditing an Indian national from Dubai. Any future UK based miscreants are not likely to be so fortunate.

http://www.fsa.gov.uk/pubs/final/rameshkumar_goenka.pdf

- **FSA fines Coutts £6.3 million in relation to structured products**

In the latest of a string of significant penalties in respect of the historic sales of structured products, the FSA has imposed a financial penalty of £6.3 million on Coutts & Company ("**Coutts**"). The penalty imposed was reduced from £9 million under the FSA's executive settlement procedures.

Specifically, the FSA found that Coutts breached Principle 9 (Customers: relationships of trust) in respect of historic sales of an AIG fund ("**the Fund**") by:

- inaccurately describing the nature of the Fund and/or inappropriately recommending to some customers that they invest in the Fund;
- failing to have in place an adequate sales process;
- failing to ensure appropriate diversification of customers' assets invested in the Fund;
- failing to adapt sales processes appropriately to changing market conditions in late 2007 and 2008, or to respond suitably to customers' queries raised during that time; and
- failing to undertake a sufficiently thorough compliance review following the suspension of the Fund.

Coutts co-operated fully with the FSA's investigation and has agreed to a review being undertaken, overseen by an independent third party, with redress to be paid to consumers in appropriate cases identified by that review.

http://www.fsa.gov.uk/pubs/final/coutts.pdf

- **Other Final Notices**

  - **Tracy McFadden**'s Part IV permission has been cancelled by the FSA, following a failure to submit a Retail Mediation Activities Return. http://www.fsa.gov.uk/pubs/final/tracy_mcfadden.pdf

- **Complaints Commissioner upholds actions of FSA in land-banking investigation**

Rejecting a complaint made by an investor that the FSA should have acted sooner to close down an unauthorised collective investment scheme, the Complaints Commissioner Sir Anthony Holland has endorsed the conduct of the FSA, which, between 2006 and 2008, sought to engage with the firm concerned in operating the scheme and its advisers and collate sufficient evidence prior to taking action

(although this is not specifically dealt with in the publicly available documents, seemingly under its power to wind up companies or partnerships on just and equitable grounds under section 367 FSMA).

The Commissioner's decision will be welcomed by the FSA as having balanced its duty to act to protect consumers with the need to surmount relevant evidential standards. Although the facts set out in the Commissioner's letter in relation to the case are scant, they show that discussions between the FSA and the firm appear to have taken place over a period of two years before action was taken in 2008. Although every case will clearly be different, it is unlikely that there will be many cases where the FSA will show such forbearance.

http://www.fscc.gov.uk/documents/final/GE-L01312.pdf

- **FSA issues policy statement on RMAR data collection (PS11/13)**

The FSA has published final rules (amending SUP 10.13.20) in relation to data to be returned by advisers as part of Retail Mediation Activities Returns. These rules, which will not come into effect until 31 December 2012, together with others arising from the Retail Distribution Review, deal with data to be collected and provided to the FSA in relation to adviser charging revenue, payment and client numbers, charging structures and complaints.

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2011/11_13.shtml

- **FSA issues policy statement on product disclosure for retail products (PS11/14)**

The FSA has published final rules (amending COBS 13) detailing the information to be provided to customers in relation to SIPPs and other pension products at the point of sale. These rules also come into effect on 31 December 2012.

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2011/11_14.shtml

- **FSA acts to safeguard ARM investors' funds**

The FSA has issued First Supervisory Notices to HSBC Bank plc ("**HSBC**") (http://www.fsa.gov.uk/pubs/final/sn-hsbc.pdf), National Westminster Bank plc ("**NatWest**") (http://www.fsa.gov.uk/pubs/final/sn-national-westminster.pdf) and Jarvis Investment Management Limited ("**Jarvis**") (http://www.fsa.gov.uk/pubs/final/sn-jarvis-investment.pdf) in respect of funds held by them on behalf of "pending investors" in bonds offered by ARM Asset Backed Securities SA ("**ARM**"), a Luxembourg based securitisation vehicle. There is no criticism of HSBC, NatWest or Jarvis, and their permissions have been varied voluntarily.

ARM's application for authorisation as an authorised securitisation firm was refused by the Luxembourg financial supervisory authorities ("**CSSF**") in August 2011. Whilst the application was under consideration prior to refusal, the issuance of bonds by ARM was suspended by agreement between ARM and CSSF. However, the bonds were still marketed to consumers in the UK, leading to monies being held in HSBC and NatWest accounts (including one in the name of Jarvis). Some of these monies remain

in these accounts. The FSA acted on 9 November to vary HSBC's, NatWest's and Jarvis' permission by requiring them to refrain from withdrawing any of these monies without the FSA's prior written consent. This move appears to have been based on uncertainty as to the status of the monies held in these accounts, a danger that, under a ruling in Luxembourg due to be announced on 10 November, that the monies may have come under ARM's control, and the FSA's/CSSF's concerns that the monies, if they were to come into the possession of ARM, would not be used in a way consistent with investors' interests.

This is the latest stage of long running action involving ARM, which has principally involved CSSF in Luxembourg and the Irish regulatory authorities, but in the course of which the FSA has taken action to seek to protect consumers' interests and has taken action against one firm (see http://www.fsa.gov.uk/pubs/final/rockingham_independent.pdf) and three individuals (see http://www.fsa.gov.uk/pubs/final/stephen_hunt.pdf, http://www.fsa.gov.uk/pubs/final/jonathan_edwards.pdf and http://www.fsa.gov.uk/pubs/final/gary_forster.pdf) in relation to the marketing of ARM bonds.

- **Requirement to record mobile communications comes into force**

The exemption in COBS 11.8.6R for mobile telephones and other mobile hand held electronic communication devices has been removed today (14 November 2011). Firms are therefore now required, under COBS 11.8, to take reasonable steps to record telephone conversations and to keep copies of relevant electronic communications (i.e. those between employees/contractors of the firm and clients, counterparties or their representatives) made with, sent from or received on equipment provided by the firm or the use of which the firm has sanctioned.

http://fsahandbook.info/FSA/html/handbook/COBS/11/8

- **Further afield**
  - **Rajaratnam ordered to pay $92.8million**

In addition to being sentenced to eleven years' imprisonment for insider dealing offences, a New York court has now ordered that Raj Rajaratnam, the former CEO of Galleon Group, pay a civil penalty of $92.8 million (being three times the $30.9 in estimated illegal profits derived from trading based on inside information). He has already been ordered to pay $63.8 million in restitution and fines in the criminal proceedings to date. The proceedings are not over yet for Mr Rajaratnam, as the SEC have filed fresh civil proceedings, linked to the prosecution of Rajat Gupta, who is alleged to have supplied inside information to Mr Rajaratnam.

http://www.ft.com/cms/s/0/d5447f1e-0a51-11e1-85ca-00144feabdc0.html

- **And finally...**

Attention last week may have been largely focused on other parliamentary committees. However, those who will be in charge at the FCA, after sessions before the Treasury Committee last week, have been spending more time at parliament as they seek to influence the shape of the draft Financial Services Bill.

Martin Wheatley and Margaret Cole, in an evidence session before the Draft Financial Services Bill Joint Committee called for the FCA to be given specific responsibilities and powers to promote competition in the banking and insurance sectors. This would represent an upgrade of the current wording of the bill, which would require the FCA to, more passively, "*discharge its general functions in a way that promotes competition*".

This suggestion is based on the experience of dealing with the PPI scandal, where, Margaret Cole suggested, the ability of the FSA to intervene to stop consumer detriment occurring was limited by its lack of specific powers to deal with competition issues. As the result of the Competition Commission's market investigation into PPI, the FSA is currently working with the OFT to seek to prevent the recurrence of problems in new payment protection products coming to the market (see the joint guidance consultation published on 1 November 2011[3]).

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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[3] http://www.fsa.gov.uk/pubs/guidance/gc11_26.pdf