FSA Update

Briefing note 20 February 2012

At the FSA last week:-

FSA fines former corporate broker £350,000 for disclosing inside information

Further to the action taken several weeks ago against David Einhorn and Greenlight Capital Inc ("**Greenlight**"), the FSA has (on 15 February) imposed a financial penalty of £350,000 on Andrew Osborne, a former corporate broker, for market abuse contrary to section 118 Financial Services and Markets Act 2000 ("**FSMA**").

The action relates to information in relation to Punch Taverns plc ("**Punch**") which, the FSA has found, constituted inside information, passed by Mr Osborne to Mr Einhorn during a telephone call in June 2009. Shortly after that telephone call, Mr Einhorn, the President and sole portfolio manager of Greenlight, who had previously declined to be wall crossed, issued instructions that Greenlight's entire holding in Punch should be sold.

Mr Osborne was the broker involved in the telephone call who, the FSA has found, passed inside information to Mr Einhorn. In a finding which further underlines all market participants' responsibilities and the need for caution in relation to inside information, the FSA has found that Mr Osborne should have realised that a number of pieces of information in relation to an imminent equity issuance by Punch, although they did not constitute inside information in isolation, did, in the circumstances of the telephone call, cumulatively amount to inside information. The FSA has also found that Mr Osborne should have raised concerns with senior management or legal or compliance colleagues when he realised that shares in Punch were being sold by Greenlight soon after the telephone call.

As it did in the action taken against Mr Einhorn and Greenlight, the FSA has acknowledged that Mr Osborne's conduct constituted an error of judgment and was not deliberate or reckless.

Separately, the FSA has issued Final Notices to Mr Einhorn and Greenlight following the expiry of the 28 day period within which Mr Einhorn or Greenlight could have referred the action taken against them to the Upper Tribunal (and during which time they have not done so). The financial penalties imposed on them have therefore been confirmed as £3,638,000 million and £3,650,795 respectively.

http://www.fsa.gov.uk/static/pubs/final/andrew_osborne.pdf

http://www.fsa.gov.uk/static/pubs/final/david-einhorn.pdf

http://www.fsa.gov.uk/static/pubs/final/greenlight-capital.pdf

FSA makes further insider dealing arrests

The FSA arrested one individual in London on 16 February in connection with an ongoing investigation into alleged insider dealing. Searches of various domestic and commercial premises were also carried out. The investigation, commenced in 2007, which is being conducted jointly with the Serious Organised Crime Agency, is described by the FSA as its largest ever insider dealing operation.

http://www.fsa.gov.uk/library/communication/pr/2012/015.shtml

Key issues

- FSA fines former corporate broker £350,000 for disclosing inside information
- FSA makes further insider dealing arrests
- FSA obtains €77,000 in redress in boiler room fraud case
- FSA investigation causes CPP to suspend listing
- FSA issues Supervisory Notice to Pritchard Stockbrokers
- FSA fines Topps Rogers and takes action against compliance manager for UCIS advice failings
- Other Final Notices
- Margaret Cole to leave the FSA next month
- FSA publishes academic research papers
- SEC action against British hedge fund and its CEO for late trading
- UK opts out of Criminal Sanctions Directive on market abuse

FSA obtains €77,000 in redress in boiler room fraud case

On 17 February, the FSA obtained an order, further to action taken in the High Court requiring **Monobank plc** ("**Monobank**") to repay €77,000 (approximately £64,000) to victims of a boiler room fraud. Mr Justice Peter Smith ruled that Monobank contravened section 21 of the FSMA by providing promotional literature stating that it was in the final stages of setting up a prepaid credit card service in the UK and Europe. The FSA has stated that Monobank was complicit with other "boiler rooms" in marketing its shares on this (false) basis, and has stated that it intends to take further action to recover further sums for redistribution to investors.

http://www.fsa.gov.uk/library/communication/pr/2012/016.shtml

FSA investigation causes CPP to suspend listing

The FSA has announced today (20 February) that **CPP Group plc** ("**CPP**") has, following consultation with it, suspended the listing of its shares with immediate effect. This follows an announcement in March 2011 confirming an FSA investigation in relation to the circumstances of sales of identity theft and card protection policies. The FSA has not commented further at this stage, other than to confirm that its investigation remains ongoing.

http://www.fsa.gov.uk/portal/site/fsa/menuitem.10673aa85f4624c78853e132e11c01ca/?vgnextoid=835f237360895310VgnVCM2000004fbc10acRCRD&vgnextchannel=56ecf414f9d35310VgnVCM2000004fbc10acRCRD&vgnextfmt=default

FSA issues Supervisory Notice to Pritchard Stockbrokers

In a Supervisory Notice dated 10 February (released on 13 February), the FSA has varied the Part IV permission of Pritchard Stockbrokers Limited ("**Pritchard**") to prevent it from carrying out any of the regulated activities for which it has permission (other than closing out transactions already commenced). The FSA has also imposed a requirement that written consent is obtained prior to the release of any of Pritchard's assets, or any customers' assets held to its order.

The action is based on concerns held by the FSA that client assets have not been adequately protected during the times when Pritchard has been responsible for them, and alleged use of client money on Pritchard's own account. The FSA has taken action as it considers that these failings have placed Pritchard in breach of Principle 10 (client money) of the FSA's Principles for Businesses ("**the Principles**") and Rule 7.3.1 of its Client Assets Sourcebook ("**CASS**"). Furthermore, the FSA has stated that it considers that the alleged failings set out in the Supervisory Notice mean that Pritchard is unable to satisfy Threshold Condition 5 (Suitability) set out at Schedule 6 to FSMA.

It is not clear which further action the FSA proposes to take. The FSA has also instructed Pritchard to contact investors by 17 February to update them in relation to the action taken to date.

http://www.fsa.gov.uk/static/pubs/final/pritchard_stockbrokers_limited.pdf

FSA fines Topps Rogers and takes action against compliance manager for UCIS advice failings

The FSA has, in a Final Notice dated 13 February (released on 15 February) imposed a financial penalty of £97,600 on and cancelled the Part IV permission of Topps Rogers Financial Management ("**Topps Rogers**"). The action has been taken in respect of breaches by it of Principle 3 (management and control) and Principle 9 (customers: relationships of trust) of the Principles.

The breaches relate to failures to ensure that recommendations provided to customers in connection with UCIS were suitable. Specifically, the FSA has found that Topps Rogers failed to establish that the applicable exemption under section 238 of FSMA applied before recommending UCIS, obtain and assess sufficient financial information, adequately assess customers' attitudes to risk, undertake adequate research, provide adequate suitability letters or explain the costs associated with recommendations.

The FSA has also found that these failures mean that Topps Rogers no longer satisfies Threshold Conditions

4 (adequate resources) or 5 (suitability) set out at Schedule 6 to FSMA.

The finding in relation to Threshold Condition 4 is based upon parallel action taken against Martin Rigney, the sole adviser at Topps Rogers. A Decision Notice imposing a financial penalty of £117,330, withdrawing his approval to perform controlled functions, and banning him from performing functions in relation to regulated activities, was issued to him on 16 November 2011 (but released simultaneously with the Final Notice issued to Topps Rogers, on 15 February). Mr Rigney is pursuing a challenge before the Upper Tribunal to the findings made by the FSA that he breached Statements of Principle 1 (integrity), 2 (due skill, care and diligence) and 7 (duty of approved person occupying a controlled function to ensure compliance by his/her firm with regulatory requirements) of the FSA's Statements of Principle for Approved Persons ("**APER**").

The publication requirements in respect of Decision Notices which have been in force since October 2010 have shed light on a growing body of references to the Upper Tribunal in respect of the responsibility of individuals for the failings of firms (see, for example, the entry in FSA Update in respect of Decision Notices issues to Martin Lafrance and Michael Thommes in July and October 2011 respectively). Decisions by the Upper Tribunal in respect of Mr Rigney's and these other references are awaited.

When deciding references such as these, and some others involving much larger firms, the Upper Tribunal will give important guidance as to the extent to which breaches of regulatory requirements by firms are attributable to the firms in which the individuals concerned occupied controlled functions.

http://www.fsa.gov.uk/static/pubs/final/topps-rogers-financial-management.pdf

http://www.fsa.gov.uk/static/pubs/decisions/dn-martin-edward-rigney.pdf

Other Final Notices

The Regulatory Transactions Committee ("**RTC**") has refused the application of **Sagarmatha Services Limited** for registration as a small payment institution under Payment Services Regulations 2009 ("**PSR 2009**") as the application submitted was incomplete. The RTC may, under the FSA's executive settlement procedures, issue a Final Notice refusing an application under PSR 2009 where, as in this case, the party concerned does not make any representations following the issue of a Warning Notice (2.1.1G and Part 2, Annex 1 of the FSA's Decision Procedure and Penalties Manual ("**DEPP**"))

http://www.fsa.gov.uk/static/pubs/final/sagarmatha-service-limited.pdf

Margaret Cole to leave the FSA next month

The FSA has announced that Managing Director Margaret Cole will leave on 30 March. The FSA's press release, issued on 15 February, states that she will remain in her current role and on the board of the FSA until that date, after which she will be on gardening leave until 31 August, but may still represent the FSA during that time in relation to issues not relating to individual regulated firms or ongoing investigations.

http://www.fsa.gov.uk/library/communication/pr/2012/013.shtml

FSA publishes academic research papers

The FSA has published four research papers by British and American academics on issues relating to market and consumer behaviour and sovereign credit risk.

Several of the issues addressed, particularly in relation to the rationality of consumers and the changes required to historic assumptions in relation to the operation of financial markets, have some resonance with points made several weeks ago by Martin Wheatley, the CEO designate of the FCA, in a speech to the British Bankers' Association (see *FSA Update* on 30 January (http://www.cliffordchance.com/publicationviews/publications/2012/01/fsa_update_-_30_january2012.html) for further details).

http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/consumer-research/bob-sugden-incoherent-prefs.ppt

http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/consumer-research/francis-longstaff-scr.pdf

http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/consumer-research/peter-tufano-mfm.doc

http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/consumer-research/jonathan-brogaard-hft.pdf

Further afield:-

SEC action against British hedge fund and its CEO for late trading

Following action taken by the US Securities and Exchange Commission ("**SEC**") arising from an investigation commenced in September 2003, a federal judge in New York has ordered British hedge fund **Pentagon Capital Management plc** ("**Pentagon**") and its Chief Executive Lewis Chester to pay a total of $76.8million in respect of improper trading spanning a period from approximately June 1999 to September 2003.

Specifically, US District Judge Robert Sweet found that Pentagon and Mr Chester engaged in "late trading", a practice whereby mutual fund shares were traded after the close of the market at 4.00 EST at pre-close prices. Allegations that Pentagon and Mr Sweet had also been involved in "market timing", a practice involving trading based on the forecasting of changes in market prices (in breach of funds' rules) were rejected.

The penalty imposed includes disgorgement of $38.4 million in profits found to have been improperly obtained, and a fine of $38.4 million. Lawyers for Pentagon and Mr Chester have indicated that they intend to pursue an appeal.

Although the subject matter and facts are different, there is some symmetry between this action and that recently taken in the UK by the FSA against New York based hedge fund Greenlight Capital Inc and its CEO David Einhorn for civil market abuse under section 118 of FSMA (see further details in FSA Update here and see a briefing note on the action taken by the FSA here).

Factors including the absence of intention (or "scienter") which, it appears, was found by the judge to have been present in the case against Pentagon and Mr Chester, precluded the SEC from taking action against Greenlight or Mr Einhorn. It is not understood that any action is being taken or is contemplated by the FSA against Pentagon or Mr Chester, and it appears unlikely that any will follow.

The decisions on either side of the Atlantic in the past few weeks have contrasted some elements of the applicable market abuse regimes. However, they, together with other cases such as the criminal trial at Southwark Crown Court of individuals in the UK and the US connected with the CFD broker Blue Index (now scheduled to commence on 16 April), also highlight the extraterritorial reach of both the FSA and the SEC. Both regulators continue to take strong action, both independently and collaboratively against parties beyond their shores.

UK opts out of Criminal Sanctions Directive on market abuse

The Financial Secretary to the treasury, Mark Hoban, has today (20 February) announced that the UK government has decided at present not to opt into the European Commission's proposal for a criminal sanctions directive on insider dealing and market manipulation, but that it hopes to be able to do so in the future.

The proposal put forward by the European Commission is for criminal sanctions to be established across Europe for market abuse offences. This is intended to complement the broader framework for tackling market abuse, which is being developed through the draft Market Abuse Regulation ("**MAR**").

The government has stated that it has at this stage chose n to opt out of the proposal as the offences of insider dealing and market manipulation are already covered by the UK criminal law (by section 52 of the Criminal Justice Act 1993 and section 397 of FSMA respectively) and as it wishes to wait for ongoing negotiation and review processes in respect of the MAR and the revised Markets in Financial Instruments Directive ("**MiFID**") to be completed. It has stated that it hopes to opt in once these proposals have progressed further.

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