

## Update

# Weekly Financial Services Regulatory Update

Week to 25.11.11

This weekly update from Clyde & Co's Financial Services Regulatory Team summarises new developments as reported by the FSA, the UKLA, the Upper Tribunal, the Financial Ombudsman Service and the London Stock Exchange over the past week, with links to the full documents where these are available.

We hope that you will find this update useful. If you have any queries about any of the information in this update or financial services regulatory matters generally, please contact James Cooper (020 7876 6388) or Dianne Bell (020 7876 6378).

If you have any comments on the content or format of the update or if you no longer wish to receive it, or have a colleague who would like to receive it, please email [financial.services@clydeco.com](mailto:financial.services@clydeco.com).

**Consultation papers:**

No new developments this week.

**Discussion papers:**

No new developments this week.

**Policy statements:**

No new developments this week.

**Press releases:**

**23 November: FSA appoints Sir Nicholas Montagu as chairman of the Financial Ombudsman Service.** The FSA has announced the appointment of Sir Nicholas Montagu KCB as the new chairman of the Financial Ombudsman Service (FOS). Sir Nicholas is currently the chairman of the Aviva UK Life With-Profits Committee, a director of the Pension

Corporation and is a former chairman of the Board of Inland Revenue. Lord Turner, FSA Chairman said that in the next few years this role with the FOS will need "a customer-service champion to help shape the Ombudsman's future role in the new regulatory structure".

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/100.shtml>

**23 November: Two arrests made in FSA investigation into unauthorised financial advisors.** The FSA, with the assistance of the West Midlands Police, has taken action against two individuals suspected of providing financial advice without proper FSA authorisation, and making misleading statements to investors. Search warrants were executed on three premises in the West Midlands. Two individuals were arrested. Nobody has been charged at this stage in connection with the FSA's investigation which is ongoing.

Making misleading, false or deceptive statements is an offence under FSMA which is punishable by fine or imprisonment of up to seven years.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/101.shtml>

**22 November: FSA fines and bans hedge fund compliance officer £14,000 for failing to act with due skill, care and diligence.**

The FSA has fined Dr Sandradee Joseph £14,000 and banned her from performing any significant influence function in regulated financial services for breaching Principle 6 of the FSA's Statements of Principle for Approved Persons. Dr Joseph was compliance officer at a hedge fund management company Dynamic Decisions Capital Management (DDCM). The firm's investment strategy resulted in a loss of approximately 85 per cent of total assets of a fund under its management in the wake of the collapse of Lehman Brothers. In 2008, to conceal the losses, a senior employee at DDCM entered into a number of contracts on behalf of DDCM investment funds for the purchase and resale of a bond. Concerns were raised by various investors that the bond was of doubtful provenance. In addition, the firm's prime broker resigned as a result of its concerns.

Despite being aware of the investors' concerns and the resignation of the prime broker, Dr Joseph failed to properly investigate those concerns or act upon the information. This led the FSA to conclude that Dr Joseph "did not engage with her responsibilities" as compliance officer. Therefore, she had failed to act with due skill and care. Tracey McDermott, acting director of enforcement and financial crime, stated that Dr Joseph had taken "far too narrow a view of her role as compliance officer" and did not understand the "wider" regulatory obligations it brings.

The final notice can be found in the relevant section of this update.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/099.shtml>

**Speeches:**

**24 November: Promoting a prudent and stable financial system.** Andrew Bailey, director of banks and building societies at the FSA, has delivered a speech at the Future of Retail Banking Conference. His speech focuses on pressures on the banking industry and in retail banking in particular.

Bailey believes that the solvency of UK banks has improved substantially since the financial crisis. Over the last 18 months, banks have achieved a major reduction in the support provided to them by the Government and the Bank of England. Bailey believes that the toughest challenge to be faced in the banking industry is establishing a clear path to reduce leverage, but to a timetable that does not damage the wider economy.

The pressure on retail banks comes from the impact of very low loan loss and arrears rates on interest margins. The FSA is conscious that, while it has set reasonably long deadlines for banks to accumulate the additional core capital to meet the Basel III standard, prolonged low returns could jeopardise that trajectory. It encourages banks to be active in raising capital where they can. Low returns in retail banking also bring into focus the issues of pricing for services. Bailey believes that the pricing of retail banking needs improving and that the notion of free banking has distorted the landscape. What it really stands for is charges levied inconsistently across products supplied by banks, with the consequence that some appear

to be free. The philosophy should be to give the public what they want but at a fair price which is transparent to them. His concluding message was that despite the pressure on the retail banking industry, there are huge opportunities to change the model to improve fairness and transparency.

[http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/1124\\_ab.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/1124_ab.shtml)

**21 November: Debt and deleveraging: Long term and short term challenges.** Lord Adair Turner, FSA chairman, has delivered a speech on the role of debt in the economy to the Centre for Financial Studies in Frankfurt. The topics covered in his speech are:

- Private debt creation
- Distinctive characteristics of debt
- Drivers of excessive and volatile leverage
- Required policy levers and reforms
- Money supply or credit supply as the policy focus
- Public debt of full sovereigns and subsidiary sovereigns
- Distinctive characteristics of sovereign debt
- Policy bias of excessive sovereign debt
- Distinguishing full sovereign debt and subsidiary sovereign debt, and
- Deleveraging issues and challenges

Lord Turner makes the following three arguments on the role of debt:

- Society cannot rely on free markets to ensure that private bank credit creation is optimal either in overall quantity or sectoral allocation. Radical prudential policy reform is needed. Credit creation must be monitored as a crucial macro-economic variable with the use of macro-prudential policy levers to influence its scale and allocation.
- At the core of the Eurozone's problem is a past failure to recognise that sovereign debt issued by a nation which no longer has its own currency is quite different from sovereign debt issued by a currency issuing power. Such "subsidiary sovereign" debt must be subject to market as well as political disciplines and, in an ideal world, would be held primarily outside the banking system.
- The deleveraging challenge now faced is so severe that it is likely to require a response which combines all of the possible mechanisms – debt servicing, debt write-down, and forms of controlled debt monetisation.

[http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/1121\\_at.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/1121_at.shtml)

**Bulletins and newsletters:**

**25 November: Handbook Development Newsletter – Issue 141.** The FSA has published the latest issue of its Handbook Development newsletter which summarises publications that the FSA proposes to publish, as well as updates on Handbook-related developments. This issue includes summaries on consultation papers CP11/24, CP11/25 and CP11/26, all on various aspects of the Retail Distribution Review, "PS11/12 – Strengthening capital standards 3" and

“CP11/22 – Transposition of Solvency II”, amongst others.  
[http://www.fsa.gov.uk/pubs/newsletters/pdu\\_newsletter\\_nov11.pdf](http://www.fsa.gov.uk/pubs/newsletters/pdu_newsletter_nov11.pdf)

#### Final notices:

**24 November: Farook Shuhaimy.** The FSA published its decision to cancel the registration granted to Farook Shuhaimy as a small payment institution under the Payment Services Regulations 2009. Shuhaimy has failed to pay fees and levies of £475 owed to the FSA, and to respond adequately to the FSA's repeated requests that he do so. These failings have led the FSA also to conclude that Shuhaimy has failed to demonstrate a readiness and willingness to comply with his ongoing regulatory obligations and deal with the FSA in an open and co-operative manner.

[http://www.fsa.gov.uk/pubs/final/farook\\_shuhaimy.pdf](http://www.fsa.gov.uk/pubs/final/farook_shuhaimy.pdf)

**22 November: Kebba Jaiteh.** The FSA has cancelled the registration granted to Kebba Jaiteh as a small payment institution pursuant to the Payment Services Regulations 2009. He has failed to pay fees and levies of £475 owed to the FSA and failed to respond adequately to the FSA's repeated requests that he do so. This has led the FSA to conclude that Jaiteh has failed to demonstrate a readiness and willingness to comply with his ongoing regulatory obligations and to deal with the FSA in an open and co-operative way.

<http://www.fsa.gov.uk/pubs/final/kebbajaitheh.pdf>

**22 November: Dr Sandradee Joseph.** The FSA has published a final notice, dated 18 November 2011, imposing a financial penalty of £14,000 upon Dr Sandradee Joseph and prohibiting her from holding a significant influence function in regulated financial services. This is due to breaches of Statement 6 (due skill, care and diligence) of the FSA's Statements of Principle for Approved Persons.

Dr Joseph held the compliance oversight controlled function (CF10) at Dynamic Decisions Capital Management (DDCM), a hedge fund management company. During her time in that role, an employee entered into a number of contracts, on behalf of investment funds managed by DDCM, for the purchase and resale of a bond. The bond was a fraudulent instrument and the employee entered into these contracts in order to conceal significant losses suffered by the funds managed by DDCM. Various concerns were raised by investors and DDCM's prime broker, who later resigned, in relation to the purchase of the bond.

Dr Joseph failed to give adequate consideration to those concerns and therefore failed to act with due skill, care and diligence in performing the CF10 role. For example, the FSA pointed out that she:

- Failed to properly investigate and act upon the information she had received. For example, she failed to properly read or give adequate consideration to the matters raised in the Prime Broker's Termination Letter when she returned from her honeymoon. This Letter

had stated that the Prime Broker was “not comfortable facilitating the settlement or payments” on the basis of its understanding of the transaction.

- Wrongly relied upon an employee and on her belief that external lawyers were instructed and would have acted on concerns as appropriate.
- Considered her CF10 role to be a reporting function with responsibility for setting up systems. She did not view compliance as something that one person was collectively responsible for.
- Failed to understand the bond so she did not consider that reviewing the documents would have made much sense to her. Instead, she took comfort in her belief that external lawyers were looking at the transaction. However, no legal firm had been instructed to carry out due diligence on the bond or to assess counterparty risk. She had not seen any legal opinion or other report by any law firm and did not take steps to confirm that a law firm had been instructed.

This led the FSA to conclude that she “did not engage with” her responsibilities as a CF10.

The press release can be found in the relevant section of this update.

[http://www.fsa.gov.uk/pubs/final/dr\\_sandradee\\_joseph.pdf](http://www.fsa.gov.uk/pubs/final/dr_sandradee_joseph.pdf)

#### Application refusals:

No new developments this week.

#### Approved person refusals:

No new developments this week.

#### Research publications:

No new developments this week.

#### Consumer research:

No new developments this week.

#### Other FSA publications:

**25 November: Notice of undertaking – RBS insurance firms.** The FSA has published an undertaking from RBS insurance firms (consisting of Direct Line Insurance Company Limited, Churchill Insurance Limited and UK Insurance Limited) under the Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083) (UTCCRs). The FSA considers that exclusion clauses relating to the firms' pet insurance policies were unfair under Regulation 5 of the UTCCRs.

The clauses state that the insurer would only pay for costs that it considered “reasonable or necessary”. The FSA feels that this term is not clearly defined, nor in plain and intelligible language. Where terms are not in plain and intelligible language they can be assessed as unfair under the Regulations and the FSA believed this term creates a significant imbalance in the parties' rights and obligations. The unfettered discretion given to the insurer could lead to detriment for consumers by limiting the cover they received, meaning that consumers could have no clear idea of what was covered by the policy.

### Further information

If you would like further information on any issue raised in this update please contact:

#### Financial Services Team

financial.services@clydeco.com

Clyde & Co LLP  
The St Botolph Building  
138 Houndsditch  
London EC3A 7AR

T: +44 (0) 20 7876 5000  
F: +44 (0) 20 7876 5111

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The RBS insurance firms have agreed to delete the clauses in question and to replace them with new terms that do not allow the insurer discretion to decide what costs or how much to pay. These new terms are set out in the undertaking.

[http://www.fsa.gov.uk/pubs/other/rbs\\_insurance\\_undertaking.pdf](http://www.fsa.gov.uk/pubs/other/rbs_insurance_undertaking.pdf)

#### UKLA publications:

No new developments this week.

#### Upper Tribunal (Tax and Chancery Chamber) (formerly Financial Services and Markets Tribunal (FSMT)):

No new developments this week.

#### Financial Ombudsman Service (FOS):

**23 November: Sir Nicholas Montagu appointed as chairman.** The FOS has announced the appointment of Sir Nicholas Montagu KCB as the chairman of its non-executive board of directors. Sir Nicholas succeeds Sir Christopher Kelly KCB, who steps down as chairman in January 2012 after seven years. Sir Nicholas is the former chairman of the Board of Inland Revenue, with over 20 years as a senior civil servant working on issues ranging from pensions to public service reform.

<http://www.financial-ombudsman.org.uk/news/updates/new-chairman-update-nov2011.html>

#### 22 November: "Arch cru"-related decision.

The FOS has published a provisional decision upholding a consumer complaint about an independent financial adviser's (IFA) advice to invest in an Arch cru fund. The provisional decision sets out the FOS's general approach to this kind of case and explains how it proposes to take into account compensation available under the FSA's package for investors.

In the provisional decision (which is subject to any further representations and evidence from the parties), the ombudsman considers:

- The suitability of the investment recommendation. The Arch cru fund was not a suitable recommendation

as it presented a significant risk to capital which should have been apparent from the information available to an experienced IFA. The consumers were inexperienced investors who did not wish to put their capital at risk. The information provided to them was not sufficient to alert them to the risks they had been advised to take.

- What the consumers would have done but for the unsuitable advice. On the balance of probabilities the consumers would have invested in a way designed to produce a return without putting their capital at risk.
- The calculation of fair compensation. It is fair and reasonable for the IFA to "make good" the loss the consumers have suffered as a result of the unsuitable advice relied upon. The material misrepresentations and potential negligence or fraud on the part of the Arch cru fund manager are considered, but no formal findings have yet been published. It is also still open for the consumers to submit a claim for payment under the Arch cru compensation scheme.

[http://www.financial-ombudsman.org.uk/publications/technical\\_notes/archcru-prov-decision-nov11.pdf](http://www.financial-ombudsman.org.uk/publications/technical_notes/archcru-prov-decision-nov11.pdf)

#### 21 November: Ombudsman News – Issue 98.

The FOS has published its latest issue of Ombudsman News. This issue contains items on the following:

- banking complaints involving cheques;
- insurance disputes about storm and weather damage; and
- Natalie Ceeney, chief ombudsman, on why PPI remains the big issue for the FOS.

<http://www.financial-ombudsman.org.uk/publications/ombudsman-news/98/98.html>

#### London Stock Exchange (LSE):

No new developments this week.