

The following Compliance articles are for the week ending 13 March 2009.

*“There is a view that people are not frightened of the FSA. I can assure you that this is a view I am determined to correct. People should be very frightened of the FSA.”*  
*Hector Sants, CEO of the FSA, 12 March 2009.*

#### **FSA – SPEECH ON INTENSIVE SUPERVISION AND CREDIBLE DETERRENCE**

On 12 March, Mr Sants, Chief Executive of FSA addressed the Reuters Newsmakers Event and became headline news himself. After a résumé on causes of the economic crisis, Mr Sants focused on FSA supervision.

Foreshadowing the Turner Review, Mr Sants stated that changes need to be made now. FSA had already embarked on a programme of supervisory change and was well down the track to completing it. The key feature was greater supervisory resource of a higher quality. FSA was on course to hire, by the end of 2009, 280 extra specialist and supervisory staff which will represent a 30% increase in their supervisory capacity. To ensure these individuals are properly equipped to do this job, FSA has introduced a new Training & Competence scheme which involves a regulatory testing regime for existing supervisors and has ensured the right mix between professional regulators and market practitioners.

There would be a supervisory revolution, significantly modifying and adjusting the historical approach. Supervision had been evidence-based, risk-based and principles-based. FSA would remain evidence and risk-based but Mr Sants went on to say that the phrase 'principles-based' had been misunderstood. “To suggest that we can operate on principles alone is illusory, particularly because the policy-making framework does not allow it. Europe, in particular, has a particular penchant for rules and in any case in a number of key areas, such as prudential, they are indeed necessary. Furthermore, the limitations of a pure principles-based regime have to be recognised. I continue to believe the majority of market participants are decent people; however, a principles-based approach does not work with individuals who have no principles.”

In the future, FSA will seek to make judgments on the judgments of senior management and take action to prevent risk to FSA statutory objectives. This is a fundamental change. It is moving from regulation based only on observable facts to regulation based on judgments about the future. This more 'intrusive' and 'direct' style of supervision is called 'the intensive Supervisory Model'.

Non-Executives will need to commit more time and raise their technical skills to exercise rigorous oversight. While these changes will warrant more support and compensation for these individuals, NEDs will also need to be more willing to challenge Executives. NEDs will need to become more like full-time 'Independent Directors'. However, even with all these changes to supervision and the wider oversight process, the principal responsibility for managing firms responsibly laid with the management themselves.

In closure, Mr Hants stated “When I took on the CEO role in the summer of 2007, my intention was to radically change the supervision practices of the FSA. I set out to ensure the FSA is seen as a Regulator which delivers 'intensive supervision' and 'credible deterrence'. The programme to achieve that goal was commenced 18 months ago and we are well on track to achieve that goal by the end of this year. The FSA is already a radically different organisation. The FSA has been seared by recent events but it is tougher and better as a result. The FSA has grown up.”

**Source: FSA Website**

### **FSA – SPEECH ON THE ROLE OF INVESTORS**

On 11 March, Mr Sants, Chief Executive of FSA addressed the NAPF conference in Edinburgh. He pointed out that that NAPF members are investors in a significant proportion of UK equities and had the opportunity to exercise indirect and often direct control and influence over the UK economy. Thus they had a major role in addressing the issues arising from the current financial crisis.

Mr Sants then went on to discuss how it could be ensured that this influence was as effective as possible. Commenting that he had in the past questioned whether investors have in all cases truly understood the products they were buying, Mr Sants questioned whether, if there had been more effective and collective shareholder intervention, the financial crisis currently being witnessed would have been as severe.

After listing the seven fundamental structural failures that led to the crisis, Mr Sants summarised what he considered the three key proximate drivers were that led to the crisis:

1. A significant increase in leverage
2. Too great a dependency by the market on securitisation and short-term wholesale funding
3. A search for yield and excessive risk

He then commented that a further defining feature of this crisis has been that these failures within financial markets, when seen through the lens of the media and individuals, have led to a negative feedback loop with public reaction often exacerbating the problems of individual firms and increasing financial instability. Mr Sants went on to focus on how investors might respond to these significant events and suggested that institutional behaviours have been driven by two principal beliefs:

1. Firstly, that market discipline will ultimately address excesses, however in practice this discipline has not been apparent in the recent financial crisis and, if anything, market behaviours have been pro-cyclical. In future both regulators and investors will have to recognise this fact and adjust accordingly. Inherent in this will be a need to intervene earlier, which in itself implies acting both on expectations of future events as well as focusing solely on historical data.
2. Secondly, has been the belief that while shareholders have responsibility as owners, ultimately if they are dissatisfied with a company their primary response is to sell the shares rather than to press for changes. However as owners, FSA would encourage focus on four issues: governance, risk management, business strategy and the issue of compensation. This would require owners to engage more actively with senior management and Non Executive Directors and organise themselves for collective action.

In closure, Mr Sants addressed the following issues:

- Investors must ensure that remuneration policies were consistent with effective risk management. While FSA will rigorously pursue this agenda, to be truly effective in bringing about change this must be in partnership with owners as they will be focused on the quantum of remuneration as well as the structure. Historically, owner influence has only been wielded at board level; it must now extend to the organisation as a whole
- Whether investors knew and understood what they were buying. The crisis has been driven by an intense search for yield; a desire to gain as much as possible at a 'risk free rate'. These imbalances stimulated demand which has been met by a wave of financial innovation in the form of complex securitisation. How many of these different ways to satisfy demand were truly understood?

- Over reliance by investors on 'normal channels of information' such as annual reports and company announcements. Long term investors must assess all risks to a business and be challenging of the information offered by a company, and interrogate that which is made freely available
- Over reliance on credit rating agencies, external advice and a willingness to accept the views presented. A particular issue was that these were often geared around quarterly reporting cycles and did not encourage investors to make a more long term assessment.

**Source: FSA Website**

#### ***FSA – SARAH WILSON, DIRECTOR OF TCF, RESIGNS***

On 11 March it was reported by Money Marketing that Sarah Wilson, Director of Treating Customers Fairly had resigned from the FSA.

The FSA was quoted as saying that Sarah, who was appointed a Director of the FSA in April 2002, had resigned for personal reasons. She will continue in her role until a replacement has been found. As well as her TCF remit, Sarah is also a sector leader across the FSA for insurance. Previously she was Director of the Retail Firms division and Director responsible for introduction of conduct of business regulation in the mortgage and general insurance sectors.

The FSA says it is currently looking for candidates to take over the role. A spokeswoman could not confirm if the Regulator is advertising the position externally or if it is seeking to fill the position from within the FSA. She said: "Sarah has given us a lot of notice so we have time to find a replacement. Sarah has made a personal decision to leave the FSA. Sarah's not leaving to move onto anything specific initially because it's unclear how long it will take to find a replacement."

**Source: Money Marketing Website**

#### ***FSA – TEST CASE ON MARKET ABUSE***

The FSA's market abuse case against Winterflood, the market maker, and two of its traders commenced before the Financial Services and Markets Tribunal on 11 March. This is an important test case which pivots on the materiality of intent to commit market abuse as a defence. Winterflood will argue that it did not intend to commit market abuse, while the FSA will contend that the market abuse regime covers non-deliberate conduct. Winterflood is not challenging the FSA's factual conclusions or the penalty imposed.

**Source: FSA Website**

#### ***FSA - STRENGTHENS ENFORCEMENT WITH KEY APPOINTMENTS***

As revealed in our Stop Press last week, on 9 March FSA announced the appointment of David Kirk as Chief Criminal Counsel. David is currently the Director of the Fraud Prosecution Service (FPS), a specialist unit of the Crown Prosecution Service.

As part of its strategy of credible deterrence, the FSA has placed great emphasis on bringing criminal actions for cases of insider dealing and market abuse. David will join the Enforcement division's specialist lawyers who focus on criminal prosecutions. He has extensive experience of this work following a career as a Partner of City law firms, at the Director of Public Prosecutions and most recently as the founding Director of the FPS.

Margaret Cole, Director of Enforcement, said: "I am delighted that David Kirk will be joining the FSA. The FSA has made a firm commitment to bringing criminal prosecutions to support our objective of achieving clean and orderly markets through credible deterrence. David will bring a wealth of experience of criminal prosecutions and will greatly strengthen our ability to bring more criminal actions as we plan to do."

David Kirk said: "This is an exciting time to be joining the FSA as it takes on more criminal prosecutions. I am looking forward to working with the strong team the FSA has already built."

The FSA has also appointed Keith Foggon to the Enforcement division as Manager of the Digital Evidence Unit. Keith was formerly head of the Digital Forensics Unit at the Serious Fraud Office and has developed wide-ranging expertise in an area that is important for the FSA's enforcement case work.

**Source: FSA Website**



### **FSA Events Monthly Update - March 2009**

Please find below an outline of our Spring Events Programme.

For full details of all our events please visit: <http://www.fsa.gov.uk/Pages/Doing/Events/index.shtml>

#### **CONFERENCES**

##### **The Turner Review Conference, 27 March 2009, QEII Conference Centre, London**

This half day conference will discuss the FSA's report on how the International Community needs to work together to respond to the causes of the global banking crisis. Confirmed speakers include: the Chancellor of the Exchequer, Lord Turner (Chairman, FSA), Hector Sants (CEO, FSA), Prof. Mario Draghi (Governor of the Bank of Italy and Chair of the Financial Stability Forum), Peter Sands (Group CEO, Standard Chartered), Paul Tucker (Deputy Governor, Financial Stability, Bank of England), Avi Persaud (Economist) and Tharman Shanmugaratnam (Singapore Minister for Finance).

##### **Financial Crime Conference, 27 April 2009, The Brewery, London**

In current market conditions it is crucial that firms have adequate systems and controls in place to protect themselves and their customers from financial crime.

At our Annual Financial Crime Conference, you can find out about the effects the economic downturn is having on financial crime, what motivates people to commit fraud and how you can make a business case for resources, as presented by some of the top speakers in the anti-financial crime community.

##### **Mortgage Conference, 12 May 2009, Renaissance Chancery Court, London**

This is a key opportunity for the FSA and the mortgage industry to work together to look at issues the market faces and consider plans for the future. For further information and to register your interest in attending please e-mail [claire.tatchley@fsa.gov.uk](mailto:claire.tatchley@fsa.gov.uk)

#### **SEMINARS**

##### **Sale and Rent Back Seminar, 16 April, FSA, London**

On Thursday 16 April, we are running our first seminar on the proposed interim regime for sale and rent back. It will give those firms affected an insight into the key provisions of the regime. Spaces are limited and early booking is advisable.

## **BRIEFINGS**

### **Payment Services Regulations 2009: The new regime, various dates across the UK**

To give firms who will be affected by the Payment Services Directive (PSD) an insight into its key provisions. The seminar will cover key areas including the scope of the Regulations, the conduct of business requirements and the process for applying for authorisation and registration.

### **ARROW® II Breakfast Briefing - Ask the Regulator, various dates, London E14**

This series of briefings may be of particular interest to firms who are preparing for an ARROW® II risk assessment. Limited to a maximum of 10 participants, this is your chance to ask the ARROW® II team straight questions and get straight answers on any aspect of ARROW® II.

## **INDUSTRY TRAINING**

### **Financial Promotion Workshops (for investment business) - additional London dates now available**

This half-day workshop is designed to provide practical help to firms, giving you an understanding of our approach to financial promotions so you are equipped to review processes within your firm. Workshops will be a combination of key messages, practical group exercises and case-study work.

## **COMING SOON**

### **Asset Management Sector Conference, 17 September 2009, London**

To register your interest in attending please e-mail [claire.tatchley@fsa.gov.uk](mailto:claire.tatchley@fsa.gov.uk)

### **Pension switching for Compliance Consultants**

To register your interest in attending please e-mail [claire.tatchley@fsa.gov.uk](mailto:claire.tatchley@fsa.gov.uk)

### **Annual Public Meeting, 23 July 2009, London**

Further information will be published on the events page shortly

**George Bylett**

**Corporate Governance Assurance Services Ltd**

**[www.cgas.co.uk](http://www.cgas.co.uk)**

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