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April 2010 / Issue 3

A legal update from Dechert's Financial Services Group

In this issue

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Financial Services UK and International Update

Client Assets: FSA Proposes to Enhance Protection

The UK Financial Services Authority ("FSA") has published a consultation paper on enhancing its Client Assets Sourcebook ("CASS") (CP10/9). The financial crisis and the administration of Lehman Brothers International (Europe) ("LBIE") highlighted a number of areas where CASS could be strengthened. The proposals in CP10/9 include the following:

- increasing rehypothecation transparency and disclosure to prime brokerage clients. This involves creating a requirement that all prime brokerage agreements contain a disclosure annex summarising the PBA's contractual rehypothecation provisions (that is, provisions that apply when a firm can use its clients' assets in specified circumstances). The FSA will also require daily reporting on client money and assets holdings to all prime brokerage clients, so that they know which of their assets have been rehypothecated;
- restricting the placement of client money in client bank accounts held with institutions within the same group to 20% of the firm's total client money held in client bank accounts;
- prohibiting the use of general liens in custodianship agreements;
- creating a new controlled function for client assets oversight, which will also be a significant influence function; and
- introducing a client money and asset return, to provide the FSA with an overview of firm-specific client asset positions and an overview of UK firms' client asset holdings, and enable it to make regulatory interventions on a firm-specific or thematic basis.

The FSA's proposals regarding prime broker reporting and rehypothecation, and the restriction on intra-group holding of client money, are subject to discussions with the European Commission.

The closing date for comments on CP10/9 is 30 June 2010. The FSA intends to finalise its revised CASS rules in a policy statement in the third quarter of 2010.

European Equity Market: Microstructural Issues

The Committee of European Securities Regulators ("CESR") has published a call for evidence on microstructural issues of the European equity market relating in particular to technology-driven developments. Responses are due by 30 April 2010.

CESR's specific questions relate to topics such as high frequency trading, sponsored access, co-location services, fee structures, "tick size" regimes and indications of interest.

Hedge Funds: Hedge Fund Standards Board – Revised Best Practice Standards

The Hedge Fund Standards Board ("HFSB") has published revised best practice standards. In July 2009, it consulted on revisions to its standards in the areas of disclosure of exit terms, and independent administration and safekeeping.

The amendments come into effect on 1 August 2010. Any funds which are HFSB signatories are recommended to review their disclosure statements in light of these amendments.

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UK: Financial Services Act 2010

The UK Financial Services Bill received Royal Assent on 8 April 2010, following the removal of a number of provisions during the "wash-up" process which precedes the dissolution of parliament before a general election.

The FSA has published a statement on the Financial Services Act 2010 ("the FS Act"), together with a related new webpage.

The main changes from an FSA point of view include:

- a new financial stability objective, which includes a duty for the FSA to determine and review its financial stability strategy in consultation with HM Treasury;
- a requirement to establish a new consumer financial education body, which will assume the FSA's current responsibilities in relation to financial education;
- notable changes to the FSA's enforcement powers, including the power to suspend individuals and firms, and to fine those who are carrying out a role that needs FSA approval without the necessary approval being in place. In addition, the time limit for issuing a warning notice against an individual is increased from two to three years from the time the FSA first becomes aware of the misconduct;
- a new power to specify that remuneration agreements in breach of the FSA's remuneration rules are void;
- enhanced powers to make rules banning short selling in financial instruments, and to require any person to disclose information about their short selling; and
- a new power to impose a consumer redress scheme.

Different parts of the FS Act will take effect at different times. The parts of the FS Act that come into effect immediately include the financial stability objective and the duty to create a consumer financial education body. Parts that come into force two months after the FS Act is passed include the power to make rules on short-selling and the enforcement powers.

Practice group contacts

For more information, please contact one of the lawyers listed, or the Dechert lawyer with whom you regularly work. Visit us at www.dechert.com/financialservices.

Karen L. Anderberg
London
+44 20 7184 7313
karen.anderberg@dechert.com

Peter D. Astleford
London
+44 20 7184 7860
peter.astleford@dechert.com

Gus Black
London
+44 20 7184 7380
gus.black@dechert.com

Martin Day
London
+44 20 7184 7565
martin.day@dechert.com

Olivier Dumas
Paris
+33 1 57 57 80 09
olivier.dumas@dechert.com

Peter Draper
London
+44 20 7184 7614
peter.draper@dechert.com

Richard Frase
London
+44 20 7184 7692
richard.frase@dechert.com

John Gordon
London
+44 20 7184 7524
john.gordon@dechert.com

Andrew Hougie
London
+44 20 7184 7373
andrew.hougie@dechert.com

Susan Lark
London
+44 20 7184 7515
susan.lark@dechert.com

Angelo Lercara
Munich
+49 89 21 21 63 22
angelo.lercara@dechert.com

Angelyn Lim
Hong Kong
+852 3518 4718
angelyn.lim@dechert.com

Stuart Martin
London
+44 20 7184 7542
stuart.martin@dechert.com

Marc Seimetz
Luxembourg
+352 45 62 62 23
marc.seimetz@dechert.com

Jennifer Wood
London
+44 20 7184 7403
jennifer.wood@dechert.com

Keith T. Robinson
Hong Kong
+852 3518 4705
keith.robinson@dechert.com

Hans Stamm
Munich
+49 89 21 21 63 42
hans.stamm@dechert.com