

**United Kingdom: IOSCO Objectives and Principles of Securities Regulation: Detailed
Assessment of Implementation**

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**International Monetary Fund
Washington, D.C.**

FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

UNITED KINGDOM

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

DETAILED ASSESSMENT OF IMPLEMENTATION

JULY 2011

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

ARROW	Advanced Risk-Responsive Operating Framework
CESR	Committee of European Securities Regulators
EEA	European economic area
ESMA	European Securities Markets Authority
ETF	Exchange-traded fund
EU	European Union
FCA	Financial Conduct Authority
HMT	Her Majesty's Treasury
IOSCO	International Organization of Securities Commissions
IFRS	International Financial Reporting Standards
FSA	Financial Services Authority
FMSA	Financial Markets Services Act
MiFID	Markets in Financial Instruments Directive
MOU	Memorandum of understanding
MTF	Multilateral trading facility
OFT	Office of Fair Trading
PRA	Prudential Regulatory Authority
RCH	Recognized clearinghouse
RIE	Recognized investment exchange
UCIT	Undertakings for the Collective Investment of Transferable Securities
U.K. LA	U.K. Listing Authority

I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

1. **The assessment was conducted during the IMF Financial Sector Assessment Program (FSAP) mission to the United Kingdom (U.K.) during the period January 17 to February 1, 2011** by Shane Tregillis of the Australian Securities and Investments Commission, acting in his personal capacity, and Jennifer Elliott, IMF.
2. **The assessment was carried out using the 2003 International Organization of Securities Commissions (IOSCO) Methodology (the Methodology) for assessing IOSCO Principles.** In using the Methodology, the assessors sought to focus on the substance of the regulatory outcomes of the key requirements under each Principle. The assessment relies on information from a detailed self-assessment submitted by the authorities, as well as extensive interviews with Financial Services Authority (FSA) staff, a review of legislation and the FSA Handbook, a sample of supervisory files and related materials along with interviews with market participants, trade associations, and other stakeholders. The assessment was done against the 2003 Principles (originally adopted in 1998). In June 2010, IOSCO adopted new principles, but a Methodology setting out criteria for the new principles is still in development. Accordingly, we have not assessed against the new Principles. A description of how the authorities are meeting or will meet the new Principles is attached in Annex I.
3. **The assessors are grateful to the staff of the FSA for their extensive cooperation and good cheer in providing the team with information in response to many and frequent requests.** The assessors would also like to thank the regulated entities, market participants, and other stakeholders who generously provided their time and candid insights.

Institutional and market structure—overview

4. **The United Kingdom hosts one of the two largest financial sectors in the world.** It is a global hub for financial services ranging (in securities markets) from the largest global investment and universal banks to very small investment advisers.
5. **The financial sector is regulated by the U.K. FSA, an integrated regulator with responsibility for regulation and supervision of the full range of financial services.** The FSA was created in 2000 under the Financial Markets Services Act (FMSA), which remains the key piece of legislation in establishing the FSA's authority and responsibilities. The FSA has developed a handbook containing most of the rules relevant to regulated entities.
6. **The U.K. securities markets are very large.** The United Kingdom is the leading equity marketplace in Europe as well as an important listing center for foreign equity issuers. At end-September 2010, it had 1,101 U.K. companies and 328 foreign companies listed on its main market, and 1,204 companies (including 224 foreign companies) admitted to its AIM market for small and medium-size enterprises. By September 30, U.K.-listed companies had a market value of £1.82 trillion and the AIM companies (United Kingdom and foreign) of

£65.6 billion. The United Kingdom hosts a wide range of organized markets (Box 1) for equities, options, corporate bonds, and exchange traded futures.

Box 1. Major Infrastructure Providers Supervised by the FSA 1/

Equity exchanges:

London Stock Exchange (inc AIM)
PLUS Markets

Derivatives exchanges:

EDX
ICE Futures Europe
LIFFE
London Metal Exchange (LME)

Clearing and settlement providers:

Euroclear U.K. and Ireland (EUI)
European Central Counterparty
ICE Clear Europe
LCH.Clearnet Ltd

Licensed overseas entities:

Trading platforms:

CBOT (US)
CME (US)
Eurex (Swiss)
ICE Futures Inc (US)
NASDAQ (US)
NYMEX (US)
NYSE Liffe US
SIX (Swiss)
Sydney Futures (Aust)

Multilateral trading facilities:

BATS Europe
BrokerTec
Chi-X Europe
EuroMTS
Icap Block Cross
Instinet Block Match
Liquidnet Europe
Pipeline Europe
Smartpool
Tradeweb
Turquoise

Clearinghouses:

Eurex (Germany)
SIS X-Clear (Swiss)
CME (US)
CC & G (Italy)
EMCF (Neth)
ICE Clear US
LCH.Clearnet SA (France)

1/Taken from FSA "Markets Regulatory Agenda," May 2010.

7. **The over-the-counter fixed income and derivative markets in the United Kingdom are large and global in nature.** London is an important center for issuance and trading of international sovereign bonds; 30 percent of the \$2.4 trillion in bonds issued in 2009 were issued in London, with 70 percent of total turnover in the international market

taking place in London, mainly in the OTC market.¹ The London Exchange is a leading platform for on-exchange bond trading, trading £4.7 trillion in bonds during 2010.²

8. **London hosts several important on-exchange derivatives markets, including NYSE-LIFFE trading key financial and agricultural futures and options; ICE Futures Europe, which supports the market for several key oil and gas futures as well as clearing for over-the-counter trading in CDS and other derivatives; and the London Metal Exchange, which trades futures and options on metals.**

9. **The United Kingdom has a large asset management market, as funds under management (for U.K. domiciled funds) reached £577.6 billion in December 2010, with total funds under management in the United Kingdom of £3.9 trillion.**³ The United Kingdom is widely recognized as a center for alternative asset management (including hedge funds). There are 450 registered hedge fund managers in the United Kingdom, managing £450 billion in assets (although this does not include the offshore domiciled assets that may also be managed from London).⁴ Exchange-traded funds (ETFs) are a rapidly growing asset class in the United Kingdom (Table 1).

Table 1. United Kingdom: Top Five Exchanges by Value of ETFs Traded in U.S. Dollar Terms in 2010

Exchange	US\$ billions in 2010	US\$ billions in 2009	Percentage Change
NYSE Euronext US	4 164,5	4 371,1	-4.7
NASDAQ OMX US	1 010,8	1 118,3	-9.6
London Stock Exchange Group	243,1	199,5	21.8
Deutsche Börse	204,7	202,9	0.9
NYSE Euronext (Europe)	154.8	111,9	38.3

¹ International Financial Services London, 2009 Bond Market Report.

² FSA data.

³ Investment Management Association estimate “Asset Management in the U.K. 2009-2010—The IMA Annual Survey,” July 2010 <http://www.investmentfunds.org.U.K./research/ima-annual-industry-survey>.

⁴ Alternative Investment Managers Association, 2009 Hedge Fund Report.

10. **There are 26, 270 regulated firms in the United Kingdom, including 2,059 authorized as investment firms, investment managers, or investment advisors.** These range from the largest, global banking groups to independent brokerage houses and investment managers to one- and two-person financial adviser firms.

FSA approach to supervision

11. **The FSA undertakes risk-based supervision and has evolved a structured approach to supervision.** The FSA has in place a “risk dashboard,” which determines risks against the statutory objectives of the FSA (market confidence, financial stability); these risks are put into various categories: environmental, business, capital, and governance. Particular lines of business or activities are then measured against the risk dashboard to determine a firm’s particular risk profile. Every firm is given an impact measure showing the potential harm to the FSA objectives if it fails or if the risks crystallize. This is a proxy for its regulatory footprint or size.

12. **Once the impact value is calculated, a firm can be classified into one of four categories: Low, Medium-Low, Medium-High, or High.** The impact metrics used to calculate the firm’s impact measures differ depending on the sector within which it operates. The risk profile is then used to categorize firms for the type of supervision they will receive. High-impact firms will receive what is called “close and continuous” supervision, with a dedicated relationship manager and team, including more than one supervisor and a manager. A medium-high impact firm may have a smaller team but still be in close and continuous contact. A medium-low to medium-high firm would be “relationship managed,” meaning that it is directly supervised on a day-to-day basis, but may be part of a group of firms supervised with a less-intensive cycle of consultations. A low-impact firm will be categorized as a “small firm” and not “relationship managed;” it would then be put into a very large pool of (16,000) firms handled by the small-firms group.

13. **Those firms that are relationship-managed are subject to an Advanced Risk-Responsive Operating Framework (ARROW) assessment.** Medium-low firms are subject to an ARROW light assessment that focuses on core areas. The ARROW determines the risk issues to be monitored by the FSA and includes a review the firm’s business model, oversight, and governance structures and operational controls. Table 2 sets out the number of firms by category in each risk category.

14. **Small firms are not subject to an ARROW review.** Small firms are, however, profiled—their reporting along with other factors (such as complaints received, type of activity, market intelligence) are used to generate a risk profile that identifies those small firms that require additional supervision. For example, the largest fund manager in the small-firm category has £10.8 billion funds under management, with a market share of .043 percent.

Table 2. United Kingdom: Number of Firms by Risk Category

Sector/Impact	Low	Medium Low	Medium High	High
Banking	32	126	45	35
Asset	13	82	45	9
Insurance	12	104	104	17
Capital markets	5	40	33	8
Retail intermediaries	16,000	47	13	1
Total	16,062	399	240	70

Source: Financial Services Authority.

15. **The FSA supplements this risk-based formula with thematic reviews.** It undertakes special inspections of samples of firms on various topics. For example, the FSA has conducted reviews of ‘spread betting’ firms to ensure internal controls are sufficient; it has also done a number of reviews looking at handling of client monies. Thematic reviews can apply to any firm.

16. **The recognized exchanges and clearinghouses are all subject to close and continuous supervision.**

U.K. regulatory reform

17. **The United Kingdom is currently embarked on a wholesale restructuring of its regulatory arrangements for the financial sector.** As discussed in detail in a separate note as part of the FSAP, the current remit of the FSA will be divided between two separate agencies: the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA). It is contemplated that, except for the prudential regulation of the very large investment banks, the full remit of securities regulation will be within the FCA, including prudential regulation of small firms, business and sales conduct regulation of all firms, regulation of secondary markets (issuers and trading systems), and regulation of asset management. The PRA will be responsible for prudential regulation of only the largest firms (generally banks and insurance companies). The current enforcement function, including criminal prosecutions, will go to the FCA. Regulation and supervision of clearing and settlement systems will be carried out by the Bank of England (BoE). A Financial Policy Committee (FPC) will coordinate financial stability across the system—the FPC will be chaired by the BoE and will include representation by the PRA and FCA as well as independent members.

European Union regulatory agenda

18. **Regulatory policy initiatives at the European Union (EU) level have become more important than domestic policy initiatives in the securities sphere.** There are a large number of directives under review or being implemented, including UCITS IV, to be implemented in July, and the Markets in Financial Instruments Directive (MiFID), which is under review. Further, the new level II European bodies for financial markets regulation have come into place. The European Securities Markets Agency (ESMA) began operations January 1, 2011. While its role continues to evolve, at present it has some direct policymaking responsibilities and will have responsibilities relating to national authorities; it will also be responsible for some direct supervision, beginning with supervision of credit rating agencies in July 2011.

Assessment challenges

19. **The IOSCO Methodology clearly requires that the assessment be made at the “point of time” of the mission.** In the current environment, given the state of dynamic flux, this poses both practical and methodological challenges. Specifically, there are three profound forces at play: the post-crisis response of the FSA itself and changes it is introducing in its supervisory philosophy and approach—as the FSA itself has noted, this is very much a work in progress; second, U.K. regulatory reform; and third, the changes to the regulatory structure in Europe as of January this year and the current heavy load of EU regulatory proposals. The report acknowledges that the task of a “point in time” assessment is a difficult one.

20. **At present, there is a highly active state of policy setting at the European level, a challenge for assessors that will be further complicated by the recent changes to the regulatory structure in Europe.** Increasingly, most of the key elements of the U.K. regulatory regime are effectively EU-determined policy transposed into U.K. rulebooks. In assessing compliance with the IOSCO Principles, this needs to be taken into account. A clear example is the current MiFID review, which has identified a number of issues in the current policy framework relevant to the quality of pre- and post-trade transparency in Europe directly relevant to the assessment of Principle 27.

21. **We have noted, where appropriate, future considerations in reference to these ongoing changes.** We also highlight below that a key challenge is the uncertainty, given the proposed new regulatory structure in the United Kingdom, and the potential impact this may have on the FSA. The FSA’s supervisory approach relies on the skills and judgment of its experienced supervisors. If there were to be a significant loss of further supervisory skills and experience in the FSA for any reason, this would call in to question the resilience of the current assessment against the IOSCO Principles. Accordingly, this assessment report will need to be read in the future alongside a careful review of how the transitional arrangements unfold in the coming period. As noted below, the assessors consider that, while the FSA is

taking active steps to manage the transition, there remain considerable risks as a result of this uncertainty over the next few years.

22. **The recent change to the European regulatory structure creates functioning pan-European regulatory bodies able to make binding technical standards.** This development will require some reconsideration as to how the IOSCO Principles can be best assessed in this context. The national regulator will now not be the only regulator or formal rule-making authority relevant for the purposes of an assessment of the Principles in European jurisdictions.

Preconditions for effective securities regulation

23. **The preconditions for effective supervision (a stable macroeconomic environment, sound legal and accounting framework, and effectiveness of procedures for the efficient resolution of problems in the securities market) appear to be in place in the United Kingdom.**

Main findings

24. **General: The methodology requires assessors to give a rating at the current point in time.** However, given the state of flux in the United Kingdom at this moment, an analysis would be incomplete without some evaluation of the direction in which the system is heading. An earlier proposal for the regulatory reform included a recommendation to move the regulation of issuers to a government department and to possibly move the FSA enforcement function to a public prosecution agency. The decision was made to keep markets intact within the FCA by keeping the United Kingdom Listing Authority (U.K. LA) with markets regulation and moving enforcement into the FCA rather than to split it off into a separate agency. In addition, the regulators' ability to use criminal sanctions when appropriate is a positive trend. These decisions appear to be widely welcomed by market participants, given their concerns with the initial proposed arrangements. We generally support these decisions, as we consider these functions and powers to be an important part of the new FCA.

25. **We also consider the new programs such as the increased focus on client assets a positive development.** This and other works in progress need to be continued and carried over as a core part of the capabilities and program of the FCA. In addition, the efforts by the FSA Board and senior management to put in place transitional structures as soon as possible are important initiatives to create some certainty for the staff and market participants, given the length of transition involved.

26. **The key risk to the system is uncertainty—a risk identified widely by market participants and by the Board and senior management of the FSA.** The sheer scale of the changes creates significant risks: the fundamental revamp in the structure of U.K. regulation, and the very full European agenda coming on top of the current demanding internal

supervisory enhancement program, which will inevitably create uncertainty and distraction with potential impact on staff retention and attraction along with resource pressures. These constitute material downside risks going forward.

27. **Principles 1–5, Principles relating to the regulator:** The FSA operates as an independent regulator with a broad remit covering all aspects of securities markets. It has the ability to act independently and has sufficient control over its budget. The structure and governance of the FSA are broadly in line with international standards. There is some lack of clarity in the mandate of the organization, which led to a less than optimal balancing of objectives leading up to the crisis. In crafting the new mandate for the FCA, the authorities should clearly set out the investor protection, fair markets, and financial stability key objectives of the organization. Resources are broadly in place, but the allocation of resources across mid-sized firms is insufficient and further, given the demands of an increased regulatory and policy agenda and a transition to a new structure, there is considerable concern that resources will be unduly constrained in the near future. The legislation does not protect the chief executive, Chairman or Board from removal without cause and this should be rectified in the FCA legislation.

28. **Principles 6–7, Principles relating to self-regulation:** Self-regulation is not widely used in the United Kingdom. The recognized investment exchanges (RIEs) and the recognized clearinghouses (RCHs) carry out some regulatory functions, chiefly market surveillance. The reliance on trading platform operators appears to be well-founded, there are good communications systems in place between the FSA and the market operators, and the FSA has an adequate oversight program in place.

29. **Principles 8–10, Principles relating to enforcement of securities regulation:** The FSA has broad powers to inspect and investigate regulated entities and, in the case of market abuse, unregulated parties. The FSA can apply administrative sanctions and has the authority to bring criminal proceedings. It can apply to a court for various civil remedies including restitution. The FSA has put in place an enhanced enforcement program, beginning in 2007, and this appears to have yielded results in creating a more credible deterrence to improper behavior. The FSA has devoted significantly greater resources to enforcement over this time period. A number of successful cases have been brought with very high fines, including some criminal convictions for insider dealing. The supervision program is well-founded and appears adequate for those firms that are identified as requiring close and continuous supervision. It is not clear, however, that sufficient attention is being paid to mid-sized firms (across all securities related activities) and, further, there is a greater need to implement “bottom up” analysis of firm operations using on-site examinations to supplement the “top-down” risk analysis. While many good supervisory initiatives have been put in place, such as the core conduct program, these are still taking hold.

30. **Principles 11–13, Principles for cooperation in regulation:** The FSA has the ability and capacity to share information and cooperate with regulators, both domestically and

internationally. It can share confidential information with any European economic area (EEA) member country without the need for a Memorandum of Understanding (MOU) and with other countries through an MOU. It is a signatory to the IOSCO Multilateral MOU and the Committee of European Securities Regulators (CESR) Multilateral MOU.

31. **Principles 14–16, Principles for Issuers:** The FSA has fully implemented the prospectus, market abuse, and MiFID directives through its rules for issuers. Requirements are in place for offering and disclosure documents. The U.K. LA, which is part of the FSA, has a full program of review of prospectuses and continuous obligations. Accounting and auditing standards are in place and auditors are subject to oversight and independence standards.

32. **Principles 17–20, Principles for collective investment schemes:** The framework for collective investment schemes is compliant with the Principles. Investment managers, even those operating funds exempt from regulation, such as hedge funds, are subject to authorization and reporting requirements. All retail funds and undertakings for the Collective Investment of Transferable Securities (UCITS) must register with the FSA (other than non-U.K. UCITS, which must notify the FSA). Funds must be established as unit trusts or corporations, with assets segregated from those of the manager. Custodians must be independent of the investment manager and funds are subject to valuation, pricing, and redemption standards. The supervision of investment managers could be enhanced, as expressed in the comments to Principle 10.

33. **Principles 21–24, Principles for market intermediaries:** The framework for licensing and ongoing requirements for market intermediaries is in place. The FSA uses a structured, risk-based approach to intermediary supervision, which brings a highly consistent and well thought out approach to applying constrained resources to a very large regulated population. The coverage, intensity, and effectiveness of supervision required by the Principles are, however, not fully in place. Greater attention to mid-sized firms, together with a slight rebalancing of the approach to include some “bottom up” assessment of firms using on-site work to supplement the top-down model approach, would enhance the effectiveness of supervision. Further, many supervisory enhancement initiatives are still in progress and the FSA is encouraged to further embed these initiatives into day-to-day supervision. Policies and procedures should be put in place for the handling of failing firms and consideration should be given to intensifying the supervision of firms, including through greater use of on-site inspections. All firms should be required to seek a third-party review of internal controls (for example, through an audit).

34. **Principles 25–30, Principles for the Secondary Markets:** There is a full program of authorization and supervision of trading systems and markets. There are robust market surveillance systems and processes in place and transaction reporting systems that encompass a significant portion of transactions completed in the United Kingdom (including designated OTC markets and organized markets). Trading systems rules and new products are reviewed

by the FSA. Fragmentation of markets has led to an erosion of transparency in markets, a matter that has been identified and is being addressed in the current review of market structure under the MiFID.

**Table 3. United Kingdom: Summary Implementation of the IOSCO Principles—
Detailed Assessments**

Principles	Grading	Findings
Principle 1. The responsibilities of the regulator should be clearly and objectively stated	BI	The mandate for the future FCA should ensure that objectives are set in such a way as to ensure that the primary supervisory outcomes for which the agency is responsible are clear.
Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers	BI	The FSA operates independently on a day-to-day basis and has adequate control over its budget. Legislation should be amended to protect against removal of the Chief Executive, Chairman and Board Directors without cause.
Principle 3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers	BI	The FSA has broad authority to carry out its mandate and currently retains the capacity to do so. Resources appear/are likely to be strained by the current regulatory agenda and transitional environment, creating a real risk of capacity erosion.
Principle 4. The regulator should adopt clear and consistent regulatory processes	FI	The FSA has strong systems in place to ensure consistency of its work and it operates with a high degree of transparency.
Principle 5. The staff of the regulator should observe the highest professional standards	FI	The FSA staff is subject to high-quality professional standards.
Principle 6. The regulatory regime should make appropriate use of self-regulatory organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets		The regulatory system relies on market operators and clearinghouses for frontline surveillance of the markets. This limited use of a self-regulatory function appears to work well. This Principle is descriptive and has no criteria; it is therefore “not assessed.”
Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities	FI	The trading platforms and clearinghouses are subject to a robust oversight regime. Rules and products are subject to regulatory review and on-site examinations are undertaken.
Principle 8. The regulator should have comprehensive inspection, investigation and surveillance powers	FI	The FSA has the powers to carry out inspections, investigations, and surveillance of the markets.
Principle 9. The regulator should have comprehensive enforcement powers	FI	The FSA has the powers to take enforcement actions, including the ability to bring administrative and criminal proceedings. It can apply to a court for civil remedies such as restitution. It is able to levy penalties that are both flexible and large enough to create credible deterrence.

Principles	Grading	Findings
Principle 10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	BI	The FSA has enhanced its enforcement program, both in terms of approach and resources, over the past several years and this enhancement has begun to show good early results. The challenge will be to sustain and build on these efforts. There is a need to enhance current supervision of intermediaries by supplementing the current top-down risk-based model with a greater degree of “bottom up” testing through the use of on-site inspections and verification on a risk basis for a wider range of intermediaries. The current supervisory enhancements are important and necessary, but many are at an early stage and very much work-in-progress.
Principle 11. The regulator should have the authority to share both public and nonpublic information with domestic and foreign counterparts	FI	The FSA has full ability to share information with foreign and domestic counterparts, provided appropriate protections are in place.
Principle 12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts	FI	The FSA is a signatory to the IOSCO multilateral MOU (MMOU) and the CESR MMOU and a number of bilateral MOUs. It receives and responds to a high volume of requests from foreign regulators.
Principle 13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers	FI	The FSA is able to provide foreign regulators with assistance in an investigation and has demonstrated its willingness and ability to do so.
Principle 14. There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions	FI	Issuers are subject to a full range of disclosure requirements, including prospectus and continuing disclosure obligations. The U.K. LA, as part of the FSA, actively undertakes review of disclosure documentation and monitors ongoing disclosure by companies.
Principle 15. Holders of securities in a company should be treated in a fair and equitable manner	FI	Shareholders protections are in place, including voting and notice rights, transaction reporting requirements, and disclosure of insider transactions. Takeover rules are subject to controls administered by the Takeover Panel. Related-party transactions are subject to disclosure and shareholder voting requirements for premium listed companies.
Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality	FI	Accounting and auditing standards meet international standards. Auditors are subject to independence, oversight, and disciplinary measures.
Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme	BI	Comprehensive requirements are in place of the authorization of investment managers and the registration of funds. As with intermediaries in other categories, wider use of onsite inspections would enhance oversight of investment managers.

Principles	Grading	Findings
Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets	FI	Investment funds must be unit trusts or corporations. There are rules in place for the safekeeping and segregation of client assets, including a requirement for an independent custodian.
Principle 19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme	FI	Collective investment scheme managers are required to make a full range of disclosure to fund investors. Investors are entitled to an initial prospectus and annual reports.
Principle 20. Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a collective investment scheme	FI	There are rules in place governing pricing, valuation, and redemption, and these must be disclosed in the fund prospectus.
Principle 21. Regulation should provide for minimum entry standards for market intermediaries	BI	There is a full set of authorization requirements applicable to different business activities. The process of authorization is systematic and organized, which is important, given the high number of authorized persons. There is a need to enhance supervision of intermediaries by supplementing the current top-down, risk-based model with a greater degree of "bottom up" testing through on-site inspections and verification on a risk basis for a wider range of intermediaries.
Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake	BI	The FSA Handbook implements the EU Capital Resources Directive (CRD) and as such, all large intermediaries or intermediaries that handle or hold customer assets or cash are subject to a capital regime sensitive to the range of risks. Very small and simple firms are subject to a flat requirement of six months expenses. All firms are subject to reporting and monitoring. All firms that are not purely advisors should be required to have their annual financial statements audited by an independent and qualified auditor.
Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters	BI	The FSA Handbook contains a full range of internal control, sales, and business conduct rules. These are reviewed as part of regular supervision. There is, however, no requirement for an external review of internal controls, although auditors are explicitly required to audit the handling of client monies. A broader remit for auditors or other independent external review of internal controls is warranted.

Principles	Grading	Findings
Principle 24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk	BI	Capital position of firms is being monitored and supervisors have a range of tools available to take action against a failing firm. A firm that falls below required capital is obliged to immediately report to the FSA. The FSA can request that the secretary of state apply to the court for a liquidator. A formal set of policies and procedures should be put in place for the handling of a failing firm, particularly for firms that are considered low-impact or small-sized.
Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight	FI	Most exchanges and multilateral trading facilities are subject to high standards for entry relating to their trading systems, trading rules, and surveillance systems.
Principle 26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants	FI	Exchanges and multilateral trading facilities are subject to a full program of continuous supervision, including on-site reviews, and reviews of new rules. New products are reviewed by the FSA.
Principle 27. Regulation should promote transparency of trading	BI	All organized markets include pre- and post-trade requirements. Further, a broad range of transactions undertaken in the United Kingdom must be reported ultimately by the authorized firms to the FSA (including all trades in securities traded on organized markets and some designated OTC markets). The competition fostered by the MiFID has, however, resulted in multiple trading venues, and because there is no European consolidated tape, there is a fragmentation of post-trade transparency. This has been recognized and is being considered in the current MiFID review.
Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices	FI	The FSA has a robust transaction reporting system in place. It works in close cooperation with the market operators, which have responsibility for real-time surveillance. There is a well thought out system of detecting, investigating, and escalating market abuse cases.
Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption	FI	The derivative trading platforms monitor large positions and all positions are reported to the FSA, along with a weekly report on the largest positions in key future contracts. Large counterparty exposures in firms are monitored through prudential supervision.
Principle 30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk	N/A	Clearing and settlement systems have been fully considered under separate CPSS/IOSCO assessments.

Principles	Grading	Findings
<i>Aggregate:</i> Fully implemented (FI) – 19, broadly implemented (BI) – 10, partly implemented (PI) – 0, not implemented (NI) – 0, not applicable (N/A) – 1.		

Recommended action plan and authorities' response

*Recommended action plan***Table 4. United Kingdom: Recommended Action Plan to Improve Implementation of the IOSCO Principles**

Principle	Recommended Action
1	Clarify the mandate of the FSA/FCA in order to provide clear guidance on priorities between potentially competing elements of the mandate (for example, between market integrity and competitiveness of the U.K. market).
2	Legislation should be amended to include clear formal terms limiting the ability of the Chief Executive, Chairman, and Directors of the Board of the proposed new regulatory authorities to be removed other than for cause.
3	The FSA Board should continue to carefully review whether resources are sufficient to handle the current regulatory agenda and transition to the new regulatory without adversely impacting core regulation and supervision activities. A review of the resources for more intensive on-site inspection of mid-size firms should be undertaken, and, in particular, to ensure that the proposed FCA is sufficiently resourced for firm-level supervision in addition to its more general sector and thematic work.
9	Authorities should consider amending the FSMA to allow the FSA to compel necessary information from any third party, regardless of whether there is a connection to the person under investigation.
10, 17, 21	Use of on-site inspections should be broadened, both in terms of coverage of mid-range firms and as a tool to test top-down risk models using a “bottom up” approach
22	Require all firms that are not purely advisory to have annual audits of financial statements.
23	A formal requirement should be introduced requiring firms to have internal controls formally reviewed by an independent third party, with reporting to the regulator.
27	The FSA should continue to actively engage through the MiFID review process to improve market quality and transparency of equity market trading in a competitive multi-trading venue environment.

*Authorities’ response to the assessment*⁵

35. **The U.K. authorities welcome the IMF’s review of the U.K.’s supervisory and regulatory framework for the securities markets.** The assessment has come at an important time for the United Kingdom, as the transition to a new regulatory structure begins, and the authorities appreciate this opportunity to comment on the review.

36. **The IMF assessment recognizes that the U.K.’s supervisory framework already demonstrates a very high level of compliance with the IOSCO Principles of Securities**

⁵ If no such response is provided within a reasonable time frame, the assessors should note this explicitly and provide a brief summary of the authorities’ reactions at the conclusion of the discussions.

Regulation and is well placed to manage the challenging task of supervising U.K.'s deep and complex markets and associated activities. In particular, the IMF notes the success of the FSA's enhanced enforcement program, which has delivered a credible deterrence to improper market behavior.

37. **The IMF's key recommendation is to increase the intensity of supervision for mid-sized securities firms with greater use of "bottom-up" analysis of firms' operations using on-site examinations to supplement the "top-down" risk analysis.** The U.K. authorities will therefore consider these recommendations, and others, very carefully in the design of the operating model for the PRA and FCA.

38. **Finally, the authorities wish to express their support for the role the FSAP plays in promoting the soundness of global financial systems.** The authorities want the PRA and the FCA to be compliant with international supervisory standards and look forward to a continuing dialogue with the IMF and other global counterparts to seek to improve the stability and effective supervision of the global financial system.

II. DETAILED ASSESSMENT

39. **The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories: fully implemented, broadly implemented, partly implemented, not implemented, and not applicable.** The IOSCO Methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The Methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

- A Principle is considered **fully implemented** when all assessment criteria specified for that Principle are generally met without any significant deficiencies.
- A Principle is considered **broadly implemented** when the exceptions to meeting the assessment criteria specified for that Principle are limited to those specified under the broadly implemented benchmark for that Principle and do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.
- A Principle is considered **partly implemented** when the assessment criteria specified under the partly implemented benchmark for that Principle are generally met without any significant deficiencies.
- A Principle is considered **not implemented** when major shortcomings (as specified in the not implemented benchmark for that Principle) are found in adhering to the assessment criteria specified for that Principle.
- A Principle is considered **not applicable** when it does not apply because of the nature of the country's securities market and relevant structural, legal and institutional considerations.

Table 5. United Kingdom: Detailed Assessment of Implementation of the IOSCO Principles

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>Structure</p> <p>The FSA is an integrated regulator with responsibility for regulation of most financial services and activities in the United Kingdom, including the regulation and supervision of investment firms, collective investment schemes, issuers of securities, and secondary markets. There are several agencies with responsibilities in this area, including the Takeover Panel, which is a separate and independent statutorily-mandated organization that has responsibility for oversight of takeovers in the United Kingdom and makes related rules and decisions, and the Serious Fraud Office (SFO), which is primarily responsible for financial crime. The Office of Fair Trading (OFT) is responsible for consumer protection, competition policy, and application across a range of areas, including certain financial services. HMT plays a role in the authorization of exchanges and clearinghouses in the United Kingdom.</p> <p>Responsibilities and powers</p> <p>The FMSA sets out the framework for financial services regulation and sets out the FSA's powers and responsibilities.</p> <p>The FSA's four statutory objectives are clearly stated in the FSMA. The objectives are:</p> <ul style="list-style-type: none"> • market confidence; • financial stability; • consumer protection; and • reduction of financial crime. <p>Financial stability has recently been added as an explicit FSA objective, reflecting a need for the agency to consider broader stability conditions going beyond individual firms.</p> <p>The FSMA s.2(3) further instructs that in discharging its functions, the FSA should take into account:</p> <p>the need to use its resources in the most efficient and economic way;</p> <p>the responsibilities of those who manage the affairs of authorized persons;</p> <p>the principle that a burden or restriction, which is imposed on a person or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;</p> <p>the desirability of facilitating innovation in connection with regulated activities;</p> <p>the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;</p> <p>the need to minimize the adverse effects on competition that may arise from anything done in the discharge of those functions;</p>

	<ul style="list-style-type: none"> • the desirability of facilitating competition between those who are subject to any form of regulation by the authority; and • the desirability of enhancing the understanding and knowledge of members of the public of financial matters (including the U.K. financial system). <p>The FSA's area of responsibility is set out in the FSMA (Regulated Activities Order 2001), which defines regulated activity in the jurisdiction. This encompasses activities such as dealing in investments as principal or agent, arranging, managing, safeguarding or administering investments, and operating collective investment schemes. The FSA is also designated by the U.K. Listing Authority (U.K. LA) under Part VI of the FSMA, giving it authority over and responsibility for all issuers, including setting and enforcing disclosure standards and admitting securities to listing. As stated above, the Takeover Panel is a separate entity that administers the Takeover Code.</p> <p>The FSMA gives the FSA responsibility for and authority to give directions, make rules, and issue codes, statements, and general guidance under specified provisions of the FSMA. Secondary legislation includes orders made by HMT and (as the location of the FSA's legislative provisions). The FSMA has provisions for the enforcement of the FSA's jurisdiction.</p> <p>Other legislation confers some regulatory responsibilities on the FSA, including the enforcement of consumers' collective interests and taking action about unfair terms in consumer contracts, investigations in relation to proceeds of crime, distant marketing of financial services contracts, money laundering, payment services, and regulating covered bonds.</p> <p>The FSA does not have express discretion to interpret its statutory authority, though In practice, the FSA is required to balance the objectives when exercising its powers and functions. The FSA has broad discretion in the exercise of its functions, although its actions are subject to the statutory principles of good regulation⁶ as well as public law principles.</p> <p>The FSA's actions and decisions are subject to judicial review in accordance with public law principles in the United Kingdom. Where U.K. legislation implements EU law, decisions relating to these laws are subject to review by the European Court of Justice (ECJ).</p> <p>Coordination</p> <p>There are no evident gaps in the regulatory mandate of the FSA or the few agencies with some responsibilities in this area. The FSA has responsibility and authority to regulate and supervise most financial services in the United Kingdom with only minor exceptions. Where other agencies—the Takeover Panel, for example—have responsibilities, coordination and cooperation are evident. The U.K. LA has ongoing communications with the Takeover Panel, as does the Enforcement Division of the FSA. The Markets division of the FSA coordinates with HMT on the authorization of markets. The Enforcement division coordinates with the SFO. There are no impediments to sharing of information between these bodies for defined regulatory purposes. The FSA and the OFT have a formal MOU setting out the terms of understanding between them and communication and coordination mechanisms.</p>
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⁶ The Principles of good regulation are promulgated by the U.K. Better Regulation Commission and apply to regulation in the U.K. broadly. The Principles are: **Proportionality** -Regulators should intervene only when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimized.; **Accountability**-Regulators should be able to justify decisions and be subject to public scrutiny; **Consistency**-Government rules and standards must be joined up and implemented fairly; **Transparency**-Regulators should be open, and keep regulations simple and user-friendly; **Targeting**--Regulation should be focused on the problem and minimize side effects.

	<p>Future</p> <p>The U.K. government has announced plans to establish two financial regulators that will replace the FSA. A new Prudential Regulation Authority (PRA) is expected to have responsibility for the prudential regulation of banks, insurers, building societies and the largest investment firms. The Consumer Protection and Markets Authority (FCA) is expected to have responsibility for the regulation of secondary markets, the U.K. LA, prudential regulation of all but the largest investment firms and investment managers, regulation of collective investment schemes and market conduct regulation for all institutions (including banks). The FCA will have a larger consumer protection remit as well. These authorities will be part of the Financial Policy Committee (FPC) chaired by the BoE, which will have responsibility for financial system stability. The U.K. government is also considering a proposal for responsibility for consumer credit regulation to move to the FCA from the OFT (consultation ends in March 2011).</p> <p>The proposed structure raises issues of overlapping mandate and coordination between agencies that do not currently exist. One particular issue that arises in the new proposal is the ability of the PRA to exercise a ‘veto’ over FCA decisions where the PRA believes the decision or action could, on balance, cause harm to financial stability. Without appropriate safeguards, this arrangement has the potential to limit FCA independence and also to cause uncertainty in decision making, particularly in times of stress. It would be important to, at the very least, have a process in place for the exercise of the veto that required the PRA to set out criteria and consultation process with the FCA prior to the exercise of such a veto. One means of achieving the latter would be to require discussion and decision at the FPC, in which both the PRA and FCA are members.</p> <p>It will be important to carefully craft mechanisms for coordination in market surveillance/ intelligence, so that the PRA develops an in-depth understanding of market issues related to large institutions, market regulation where large institutions also operate MTFs, prudential regulation where both authorities have responsibilities, so that there is consistency of approach and on group-wide supervision where a group may include both large and small institutions and asset management. The FSA management appears to be well aware of these issues and they are on its risk radar.</p>
Assessment	Broadly implemented
Comments	<p>The objectives and responsibilities of the FSA are clearly set out in the FSMA. There is also clarity of roles between the FSA and other agencies with a related remit. There is good communication between the U.K. LA and the Takeover Panel, the SFO, and HMT. HMT plays a role in approving exchanges and clearinghouses before they are granted recognition by the FSA. HMT also receives a report from the Office of Fair Trading on whether there any competition issues involved. The assessors were satisfied that the FSA undertakes the substantive evaluation of whether the exchange and clearinghouse complies with the relevant recognition requirements.</p> <p>There is, however, some potential conflict between the FSA’s stated objectives and the FSMA framework furthering refining the FSA approach to regulation: specifically, the instructions in s.2(3) of FSMA to take the U.K.’s global competitive position into account. The FSA Chairman has publicly noted that the rhetoric of FSA’s mandate was a contributing factor to a philosophy of supervision leading up to the crisis; words do matter. On one view, the interpretation of its goals and approach has been responsible or at least was inadequate to act as some constraint for the ‘light touch’ approach to supervision for the largest institutions that proved insufficient leading up to the crisis. While there has been a strong emphasis on consumer issues relating to sales practice, there also seems to be some gap in the approach to the prudential soundness of wholesale firms under the current mandate. While the FSA has responded to its own failings with a more intensified approach to supervision across both prudential and market regulation, other elements such as global competitiveness are still part of the FSA’s official remit, with the potential to muddy the waters.</p>

	<p>The mandate of the FSA (or the new FCA and PRA) should seek to more clearly give more emphasis to the primary objectives of prudential supervision, market integrity, and consumer confidence in the institutions they deal with and the financial products and services they purchase. This is not to suggest that efficiency, competition, and innovation along with a weighing of costs and benefits of regulation do not need careful consideration by the FCA. The issue will be how they are expressed and interpreted by the relevant agencies if they are listed objectives or factors to be taken into account. The mandate for the future FCA should set out its objectives, so that the primary supervisory and regulatory outcomes for which the agency is responsible are clear.</p>
<p>Principle 2.</p>	<p>The regulator should be operationally independent and accountable in the exercise of its functions and powers.</p>
<p>Description</p>	<p>Independence</p> <p>a. Governance</p> <p>The FSA Board is appointed and removed by HMT in accordance with Schedule 1 of the FSMA. Appointments are made on in consultation with and recommendations from, the FSA. In addition to the Chairman and Chief Executive, there are currently three Managing Directors and nine nonexecutive members of the Board, of whom one, the deputy governor (Financial Stability) of the BoE, is an ex officio director. One of the nonexecutive members is Deputy Chairman and ‘lead’ nonexecutive. Nonexecutive directors constitute the majority of the Board. There are no specific criteria for appointment or removal of Board members or the Chairman in the FSMA. Terms of appointment are set out in individual contracts; Board members normally serve a period of three years, which can be renewed.</p> <p>The FSA operates independently of HMT and other government bodies on a day-to-day basis with the ability to make rules give directions etc. without reference to or consultation with government. The FSA Board does not become involved in specific individual regulatory decisions, other than approving rules. Day-to-day decisions are made by the Chief Executive or delegated by him to appropriate managers and staff.</p> <p>b. Interaction with government (approvals and decision making)</p> <p>The FSA has the authority to make rules under the FSMA. In practice, it provides HMT with notice of proposed rules and HMT may comment on the rules but has no formal role in approving them. Under the FSMA, the FSA is obliged to consult with consumers and “practitioners.” In practice, the FSA publishes all rules for comment, and in publishing the final rule produces a summary of comments received and describes how these are addressed, where appropriate. A formal cost/benefit analysis is done for the new rules, setting out the impact and cost the rule will have and outlining the benefits.</p> <p>The FSA grants an authorization to Registered Clearinghouses (RCHs) and Recognized Investment Exchanges (RIEs) once HMT has given its approval to do so. Under the FSMA, both the OFT and the FSA provide HMT with reports in response to an application and, in practice, HMT grants authorization on the recommendations of the FSA. HMT does not have ongoing involvement in supervision of the RCHs or RIEs. The FSA has the power to revoke an RIE or RCH authorization under Part XVIII FSMA.</p> <p>c. Funding</p> <p>The FSA is funded through the levy of fees on regulated industry. This is done on a cost-recovery basis. The Annual Funding Requirement (AFR) is determined by the FSA by evaluating the resource needs of its various work streams for the year to come. The AFR is allocated across “fee blocks,” which represent the regulated business activities that regulated entities are permitted to undertake, e.g., deposit taking, insurance, and asset management. The allocation of aggregated costs is done with a view to reflecting the varying risks these sectors pose to the FSA’s statutory objectives. Recovery of the allocated costs from the regulated entities within the fee blocks is determined based on the size of the permitted business the regulated entities undertake in the fee-block. Size being a proxy for potential impact, should that</p>

	<p>regulated entity fail. Regulated entities deemed to have greater potential impact pay a greater proportion of fees in the fee-block.</p> <p>Funding has increased significantly over the past five years, reflecting the FSA's desire to intensify supervision, with the largest portion of the increases going to staff costs. Government does not play a role in budgetary decisions; however, there are indications that the FSA is likely to be under pressure to constrain funding increases given the current broader fiscal and economic environment in the United Kingdom.</p> <p>The FSA collects penalties in enforcement cases (£79.1 million in the period April 2010 to January 2011) and applies the amount of the penalty first to offset the cost of the enforcement case. Any surplus is then applied to reduce the fees of firms in all fee-blocks (including the fee-block the case related to) although the firm in question does not benefit from the reduced fees.</p> <p>d. Legal protection</p> <p>Schedule 1, Part IV of FSMA provides exemption from liability in damages for the FSA and any person who is or is acting as a member, officer or member of staff with the effect that none of the foregoing persons can be liable in damages for anything done or omitted, except in bad faith, in the discharge or purported discharge of the FSA's functions. There is no provision for indemnity of legal expenses.</p> <p>Accountability</p> <p>a. To government</p> <p>Details of the relationship between the FSA and HMT are set out in an Exchange of Letters between the Chancellor and the then-Chairman of the FSA in December 2001. This exchange sets out HMT's expectations that the FSA will act as an independent regulator on a day-to-day basis.</p> <p>The FSA makes an annual report to HMT, which includes a discussion and analysis of the discharge of FSA's functions, how regulatory objectives have been met, and how the FSA has taken into account the factors set out in s.2(3) of FSMA (elements of regulatory approach). The report also includes financial statements audited by an external auditor. This report is made public and is available on the FSA website. The FSA is also obliged to hold an annual open meeting to discuss this report and take comments on its content.</p> <p>In accordance with the FSMA, the FSA may be called to appear before the Treasury Select Committee, a committee of the House of Commons, formed to check and report on areas of treasury responsibility. The FSA has made a number of such appearances, particularly in the wake of the financial crisis. For example, the Select Committee directed an internal audit of FSA supervision of Northern Rock following its collapse. This was followed by a broader review by the FSA's Chairman on the causes of the crisis (the Turner Review).</p> <p>a. To the public (transparency)</p> <p>All FSA rules and procedures can be found on its website (with the exception of some internal procedures for day-to-day use). It makes a very strong effort to be transparent and has adopted a 'plain language' communications mandate that aids the public in understanding its publications.</p> <p>The FSA also has an internal, but independent, Complaints Commissioner to whom the public or regulated entities may complain about the FSA itself. There is also an external Financial Ombudsman to whom members of the public may complain about financial services entities.</p> <p>b. External appeal</p> <p>The FSA is subject to procedural requirements for its decision-making and the issue of regulatory notices (including statutory warnings, decisions and final notices in respect of key decisions). The FSA is not bound to provide written reasons for its decisions, but it will, in practice, do so for all significant decisions. Part XXVI FSMA lays out the process for the issuing of statutory warning, decision and final notices in respect of certain key decisions (i.e.,</p>
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	<p>decision to issue a sanction or refuse an authorization). These notices must set out the reasons for the decision. All decisions of the FSA may be subject to judicial review. Final decisions of the Regulatory Decisions Committee, which makes decisions to apply remedies such as fines or to revoke licenses etc., are subject to appeal to the Upper Tribunal (Tax and Chancery Chamber). Decisions of the Upper Tribunal can be appealed to the Court of Appeal.</p> <p>c. Confidentiality obligations</p> <p>Section 348 of the FSMA sets out an obligation for the FSA to keep all information for regulatory purposes confidential unless specifically exempted, for example, for information sharing with counterparts under an information sharing agreement. More broadly, s. 348 requires all confidential information received to be kept confidential except where consent is given for disclosure or where an information sharing ‘gateway’ permits disclosure.</p>
Assessment	Broadly implemented
Comments	<p>The FSA operates independently on a day-to-day basis. It has adequate control over its funding. FSA employees are adequately protected from personal liability. Sufficient accountability mechanisms are in place including annual reporting, audited financial accounts, obligations to consult on rules and transparency obligations. There is sufficient due process in decision-making and appeal of key decisions is available.</p> <p>While the governance structure, which emphasizes the use of nonexecutive independent directors, is generally sound, there is insufficient formal protection from removal from office for Board members, the Chairman and the chief executive. Each of these serves at the pleasure of HMT and can be removed at will, although their personal employment contracts may specify terms and criteria for removal, this is not in legislation. While this has not happened in practice, and there are probably reputational and other institutional constraints in it occurring, given the identified need to intensify supervision, it will be important to further strengthen formal safeguards to reinforce independence. Accordingly, legislation should set out the terms of appointment Board members and the Chairman and stipulate specific and limited “for cause” criteria for their removal in the interim.</p>
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>Powers</p> <p>The FSA has full authority under the FSMA to authorize, supervise, and discipline investment firms, asset managers, issuers, and collective investment schemes. It has the power to supervise and discipline RIEs and RCHs once these have been granted a license. Specific provisions are set out in Principle 1, with enforcement provisions set out under Principles 8 and 9.</p> <p>Resources and capacity</p> <p>As described under Principle 2, the FSA sets its own budget under a yearly business plan. The 2010/11 AFR was £454.7 million, 9.9 percent higher than the previous year and reflecting plans to deliver more intensified supervision. The FSA has flexibility to allocate resources according to its priorities. The FSA undertakes a regular assessment of its own operational risks and ability to retain staff capacity and focus during the current regulatory transition has been identified as a key risk. Staff turnover has returned to its pre-crisis level (10%). The FSA Board and senior management are seeking to reduce uncertainty for staff as the FSA transitions to the new regulatory structure. The move to new internal structures that are intended to broadly mirror the new regulatory authorities, the PRA and FCA, within the FSA by April 2011, will have some benefit in this area. Nevertheless, it is clear to the assessor from their discussions with FSA staff and market participants that a considerable degree of uncertainty will exist for some time with consequential impact on staff turnover.</p> <p>There is currently 3,900 staff at the FSA, drawn from a diverse set of professional backgrounds. The FSA seeks to recruit and retain specific skill sets which are in high demand in financial services. The FSA sets its pay around the industry median, and by offering staff broad-based careers with opportunities to specialise. Bonuses are added to salary and can be significant in the case of high performing staff. It also places importance on the graduate recruitment program.</p>

	<p>The FSA has developed extensive training programs for staff encompassing the whole range of regulatory responsibilities. The FSA has introduced recently the Training and Competence Scheme which seeks to provide clear paths to attaining and maintaining competence (mainly through training), facilitate supervisory activity, and support and enhance the existing FSA procedures and performance management processes.</p> <p>The FSA allocates budget resources along activity lines based on its assessment of the importance of risks the line of activity addresses. The FSA has a comprehensive process of analysis to make this determination—firms and activities are judged against their potential impact on the statutory objectives of the FSA (market confidence, consumer protection, financial stability etc.) should they fail, as well as their potential for failure given the robustness of their internal systems and controls. This means that since the crisis more resources are being dedicated to the very high impact firms and activities. However, in discussions with various units in the agency it is also clear that top-down budget outcomes frame this risk analysis and the parameters of high and medium impact are adjusted to allow for operations fall within the budget.</p> <p>There is a concern that combined with the inevitable resources taken up with the transitional issues to the new structure and recognition of the importance of actively engaging with Europe, resourcing for mid-level wholesale intermediaries and asset managers may be constrained. The threshold to be classified as high impact in this area is very high and, as a result, financially important and operationally complex midsize wholesale firms may not be receiving adequate supervisory attention. Specifically not many investment businesses (other than the very large banks) receive some form of regular, in-depth onsite examination (although they may have various management meetings or have some onsite review during a thematic review).</p>
Assessment	Broadly implemented
Comments	<p>The current allocation of resources risks resulting in a lack of in-depth supervision of mid-sized investment businesses and asset managers. This risk increases in the present context where resources will be inevitably stretched by the demands of developing the more intensive supervisory approach, transition to the new U.K. regulatory structure and demands of appropriately engaging with a full European regulatory agenda. This allocation and overall resource levels should be reviewed to ensure appropriate resources are being devoted to support more intensive supervision, including sufficient on-site testing and verification on a risk basis of more of these wholesale mid-size firms.</p> <p>There is serious concern that the disruptions and uncertainty generated by the transition to the new regulatory structure is already having a negative impact on the FSA’s ability to meet demands. The authorities should continue with their current efforts addressing the uncertainty arising from the transition to the new structures. Special attention should be paid to the structure and staffing of the FCA and efforts should be made to ensure staff is retained for that body. The FCA will have a large mandate covering the prudential and market conduct for the overwhelming percentage of the authorized population, and will be responsible for integrity of the primary and secondary markets. At the same time, given the post-crisis focus on the high risk banks, there is a risk the FCA may appear to be operating in the shadow of the more visible PRA, particularly given the proposal that the PRA be in a position to veto FCA decisions.</p>
Principle 4.	
Description	<p>The regulator should adopt clear and consistent regulatory processes.</p> <p>Procedures and rules</p> <p>The FSA is required to follow clear and consistent regulatory and decision-making processes under legislation and principles of public law. The FSA has developed extensive internal procedures aimed at achieving consistency and efficiency. These are available on the public website. All rules and guidance are also available on the website and to the extent possible publications are written in ‘plain language.’</p> <p>The FSMA requires the FSA to consult consumers and practitioners through representative</p>

panels and publish a draft of proposed rules and guidance. The FSA is required to give notice of major regulatory decisions. In particular, s. 393 FSMA provides for third parties to be sent a copy of a warning notice where any of the reasons contained in the notice relates to a matter which identifies a third party other than the notice recipient, and the FSA considers that the matter is prejudicial to the third party. As a matter of practice, the FSA also provides written reasons for other decisions. The FSA is required to publish feedback statements, consultation documents and policy statements showing final policy positions taken and, where appropriate, the reasons for the positions. The FSA conducts and publishes a cost benefit analysis before issuing notices, rules or codes containing guidance about market abuse. As a matter of practice, the FSA also publishes a cost benefit analysis for significant guidance on other topics. The cost benefit analysis allows an evidence-based assessment of a proposed policy's economic impacts on all relevant stakeholders.

Decisions

Criteria for granting, denying or revoking a permission are set out in the FSA Handbook and are available to the public either through the website or publication. The rights of applicants are also contained in the FSMA. The process for making a complaint to the independent complaints commissioner is contained in the FSA Handbook.

The FSA is obliged to issue its regulatory decisions by serving a "statutory notice" (warning notice, decision notice or supervisory notice) to the relevant person (Part XXVI of FSMA). Notices must be served in accordance with approved method set out in the FSMA (Service of notices) Regulations 2001. Acceptable methods include delivering the notice to the recipient in person, leaving it at or sending it to the recipient's address and transmitting the notice via fax or e-mail to the recipient. The FSA is required to publish statutory notices in accordance with section 391 of FSMA. It has discretion not to publish a notice where, in its opinion, this would be unfair to the person in respect of whom the decision was taken or prejudicial to the interests of consumers.

The FSA is also subject to other legislation (e.g., the Freedom of Information Act 2000) and judicial review, which in practice, means that written reasons are normally produced. Section 393 FSMA provides for third parties to be sent a copy of a warning notice where any of the reasons contained in the notice relates to a matter which identifies a third party other than the notice recipient, and the FSA considers that the matter is prejudicial to the third party.

The FSA does not generally make reports on investigations public. However, details of an enforcement action that is set out in a final notice will generally be published. The FSA is currently consulting on whether it will, in the future, publish decision notices as well as final notices (consultation closed 14 December 2010). The Chairman has recently expressed his view that in certain circumstances (specifically related to the investigation into handling of the Royal Bank of Scotland leading up to the crisis) investigations should be made public.

In publishing any information, the FSA is required to comply with provisions about confidential information under the FSMA and the provisions about personal data under the *Data Protection Act 1998*.

Paragraph 7 of Schedule 1 FSMA requires the FSA to maintain a complaints scheme for the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of its functions under the Act (other than its legislative functions). The FSA appoints an independent person as Complaints Commissioner to be responsible for the conduct of investigations into complaints made against it.

Consistency of application

The employee Code of Conduct requires FSA staff to observe procedural fairness in performing their functions. There are a number of features to the organization of work at the FSA that are

	<p>designed to promote consistency including the formalized approach to determining risk profile and supervisory priorities, the use of panels to review ARROW assessments, and internal audits of various strands of work.</p> <p>Investor education</p> <p>In 2010, responsibility for investor education programs was passed from the FSA to the new Consumer Financial Education Body (CFEB). The CFEB is responsible for a national education program called the Money Guidance service, and for continuing operations of the financial capacity division previously housed in the FSA.</p>
Assessment	Fully Implemented
Comments	The FSA operates at a very high level of transparency. It is also very focused on establishing clear procedures for all aspects of its operations.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	<p>The FSA has established a Code of Conduct for staff. The Code requires all employees to disclose investments in or other relationships with relevant organizations (regulated entities etc.) and formal permission must be sought to trade in securities or investments in relevant organizations. Employees are required to sign declarations and continuously update them. The employee's line manager must sign the declaration as well. The Ethics Officer (currently the head of internal audit) is appointed to ensure all employees comply with these requirements.</p> <p>The Code requires staff to maintain the confidentiality of information obtained in the course of work, complementing s.348 FSMA, which imposes restrictions on the disclosure of confidential information, and the Data Protection Act 1998. The employee Code of Conduct requires FSA staff to observe procedural fairness in performing their functions.</p> <p>Allegations of violation of professional standards may be investigated by internal processes (through referral to senior management) and disciplinary options. The FSA complaints scheme provides a mechanism to address complaints alleging mistakes and lack of care, unreasonable delay, unprofessional behavior, bias and lack of integrity. The FSA also has an internal whistleblower program, which is widely advertised. Criminal sanctions may be imposed for breaches of s.348 FSMA.</p> <p>In keeping with public law principles, any allegations of procedural unfairness can be the grounds for judicial review of any FSA decision.</p>
Assessment	Fully implemented.
Comments	FSA staff is subject to high professional standards including those related to conflicts of interest and the handling of confidential information.
Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of Self Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	<p>There are no organizations which establish general rules of eligibility for participation in securities activity, or which have powers to bar a person from participating in securities business, except the FSA.</p> <p>The only limited areas within the financial sector in which the framework provides for any significant elements of "self-regulation" relate to the rules for members of/participants in specific market infrastructures. These encompass RIEs and RCHs – collectively, Recognized Bodies (RBs). Additionally, MiFID has, since November 2007, formalized the regulation of MTFs in the EU and these are also required to have rules for participation in their facilities. However, these entities have regulatory responsibility for participants within very limited parameters. They also</p>

	<p>have responsibility for ensuring arrangements are in place for monitoring and detecting market abuse and ensuring that they meet the requirements for orderly and proper markets.</p>
	<p>The RBs are not responsible for overseeing their members' and participants' activities generally, which is the responsibility of the FSA (or, in the case of a non-U.K. participant, of that participant's home-state regulator), and they have only a limited role in the processes for admitting securities to trading.</p> <p>The RBs must also operate within a framework that must comply with the Recognition Requirement Regulations drawn up by HMT, together with guidance on those requirements and notification rules set out by the FSA in the sourcebook for Recognized Investment Exchanges and Recognized Clearinghouses (REC).</p> <p>The FSA is responsible for oversight of RIE and RCH compliance with the recognition requirements, and for the compliance with FSA rules of authorized investment firms operating MTFs. The FSA has an active program of oversight and supervision of these entities to ensure compliance with their recognition or authorization requirements.</p>
Assessment	Not assessed.
Comments	<p>The U.K. regulatory framework has a very limited role for self-regulation relating to the rules for members of/participants in specific market infrastructures. There are the RIEs and MTFs who are required to have rules for participants in their particular services. They are also required to have the surveillance systems in place to ensure they can monitor trading on their markets, detect market abuse, and maintain an orderly and proper market. These obligations are clearly set out and subject to oversight by the FSA. These entities do not, however, operate as formal delegates of the FSA and the primary supervision of market participants rests with the FSA for U.K. participants and the relevant home regulator for non-U.K. participants.</p> <p>This Principle is rated 'not assessed' because IOSCO has determined no criterion exit for the Principle and it is used for descriptive purposes only.</p>
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>As set out above, the use of self-regulation is limited in the United Kingdom. Where the entities do have a role in setting rules of the use by participants of their services or have a role in monitoring and detecting market misconduct, their obligations are set out in the relevant authorization or recognition requirements of the FSA or relevant recognition regulations. The FSA also has an oversight role for these entities. The requirements relevant to this principle are set out below.</p> <p>Authorization or delegation subject to oversight</p> <p>An RB must be a fit-and-proper-person and have in place the necessary arrangements, policies, and resources to meet its obligations. An RB's rules must be transparent and nondiscriminatory and be based on objective criteria. The rules must govern access to, or membership of, and its facilities; provide for fair and orderly trading; and establish objective criteria for the efficient execution of orders.</p> <p>An RB must consult with users when making or amending rules and have provisions in place that ensure fair, independent and impartial resolution of appeals against its disciplinary decisions.</p> <p>While an RIE is required to have rules that ensure that trading by its members on its facilities takes place in an orderly manner and affords proper protection to investors, an RIE is not responsible for the general 'client-side' conduct of investment firms. That is the responsibility of the FSA (recognizing that in today's market an investment firm may act for clients, and trade on own account on many different, and competing, trading venues).</p>

	<p>The RIEs must notify the FSA of any changes to its constitution and regulatory rules. In practice, the RIEs normally consult informally with the FSA at an early stage when considering any significant rule change. Public consultation on rule changes is initiated by the RIE itself. The RIEs are required to have appropriate procedures for making rules, keeping them under review and amending them. The FSA must formally approve any changes to an RIE's default rules (Companies Act 1989, section 157).</p> <p>An RIE must be able and willing to share information with the FSA or any other authority, body, or person having authority in the United Kingdom for the supervision of any regulated activity or other financial service, or with an overseas regulator within the meaning of s.195 of the FSMA.</p> <p>An RIE must have effective arrangements for monitoring and enforcing compliance with its rules, including powers to take disciplinary action, suspend a member and refer a member conduct to the FSA or other authority for investigation. An RIE is required to retain authority over a member for at least one year after the member has ceased to be a member for disciplinary purposes.</p> <p>Oversight</p> <p>The FSA is responsible for ensuring, on an ongoing basis, that recognized bodies remain in compliance with the Recognition Requirement Regulations. It discharges this responsibility through a structured approach to oversight. This involves the use of dedicated teams who are responsible for 'close and continuous' supervision and for periodic (invariably annual) assessment of the overall risks posed by the RB to the FSA's statutory objectives and the determination of how these risks are being addressed by the RB. The periodic risk assessment involves meetings with senior management, the board of the entity and in some cases on-site examinations. The assessment is subject to review by an FSA panel and is delivered to the board of the RB.</p> <p>Professional standards similar to those expected of a regulator</p> <p>In relation to confidentiality, the FSA requires the systems and controls are intended to ensure that confidential information is used only for proper purposes. An RB is required to make provision in its disciplinary processes for the fair, independent, and impartial resolution of appeals against its decisions and to have effective arrangements for the investigation and resolution of complaints, including arrangements for a complaint to be fairly and impartially investigated by a person independent of the RB and for that person to report the result of the investigation to the complainant, and to have the power to recommend a compensatory payment or remedial action, or both.</p> <p>Where relevant, RBs will have to comply with FSMA s.348 (restrictions on disclosure of confidential information by the FSA etc.) and regulations made under s.349 (exemptions from s. 348) of the FSMA.</p> <p>Conflicts of interest</p> <p>The recognition requirements state that RB must ensure that appropriate arrangements are made to identify conflicts between the RB, its owners and operators, and the interests of the persons who make use of its facilities or the interests of the financial markets operated by it, and to manage such conflicts so as to avoid adverse consequences for the operation of the financial markets operated by the RIE/RCH and for the persons who make use of its facilities.</p>
Assessment	Fully implemented
Comments	The U.K. system does not formally delegate regulatory powers to self-regulatory entities. Those entities such as RIEs and MTFs that make rules for participants and have obligations for monitoring the conduct of trading on their markets are subject to detailed requirements for

	<p>recognition or authorization, making transparent and nondiscriminatory rules, provision of information to the regulator and effective arrangements for monitoring and enforcing compliance with its rules. They must also be able and willing to cooperate by sharing information, ensure relevant confidentiality, and have processes for managing conflicts of interests. The FSA is responsible for ensuring on an ongoing basis that RBs remain in compliance with the Recognition Requirement Regulations. They have an active supervisory oversight program for these entities.</p>
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers
Description	<p>Inspection and investigations powers</p> <p>The FSMA gives the FSA broad powers to inspect the business operations, books, and records of a regulated entity. Section 165 gives the FSA authority to require an authorized person to provide specified information or documents, provided the information and documents are reasonably required in connection with the exercise of the functions conferred to the FSA. In carrying out an enforcement investigation, the FSA also has powers under ss.171-173 to compel information through an interview or otherwise. The FSA can require this information in response to a particular inquiry or on a routine basis. The ability to obtain information under these powers is specifically extended to persons connected to regulated entities (e.g., significant owners), depositaries for overseas collective investment schemes and RIEs and RCHs.</p> <p>Authority to supervise trading systems</p> <p>As described in Principle 25, RBs are recognized by the FSA and granted an exemption from authorization under the FSMA by the FSA. The RB must first have approval of HMT, which is made upon the recommendation of the FSA and supervised by the FSA. The FSA has the authority to revoke recognition if the RIE has failed to satisfy the recognition requirements or is failing, or has failed to comply, with other obligations imposed by FSMA (s.297(2)). The FSA has authority to oversee investment firms which hold a permission to operate an MTF under FSMA Part IV (definition of regulated activities). The FSA is responsible for overseeing these firms' compliance with the rules for the operation of MTFs (set out in the FSA Handbook MAR 5).</p> <p>Record keeping</p> <p>An authorized firm is required by FSA rules to arrange for orderly records to be kept of its business and internal organization. These include all services and transactions undertaken by the firm, for a period of at least five years. The records must be sufficient to enable the FSA to monitor the firm's compliance with the requirements under the regulatory system (FSA Handbook SYSC 9.1).</p> <p>RIEs must maintain an audit trail of transactions for at least three years and for five years in respect of transactions carried out by members who are not incorporated in the United Kingdom.</p> <p>Account monitoring</p> <p>Regulation 19 of the Money Laundering Regulations 2007 requires regulated entities to maintain records evidencing its customers' identities for five years from the end of the relationship or transaction with the customer. Authorized firms are required to maintain records of transactions which must be sufficient to enable the FSA to monitor compliance with the requirements under the regulatory system. They must do so in a form that allows the FSA to readily access the information and to reconstitute each key stage of the processing of the transaction. (SYSC 9.1). Regulation 8 of the Money Laundering Regulations 2007 also requires firms to conduct ongoing monitoring of business relationships (including reporting suspicious transactions).</p>

	<p>Regulation 20 of the Money Laundering Regulations 2007 requires firms to have in place policies and procedures to prevent activities related to money laundering and terrorist financing. The FSA also has rules requiring firms to establish, implement and maintain adequate policies and procedures sufficient for countering the risk that the firm might be used to further financial crime. These policies and procedures include systems and controls to identify, assess, monitor and manage money laundering risk. Firms are also required regularly to assess the adequacy of these systems and controls to ensure ongoing compliance.</p> <p>Client identity</p> <p>Firms are required under Money Laundering regulations to maintain records evidencing customer identity for five years. The FSA can require client identity information under its general powers (FSMA s.165).</p> <p>Outsourcing</p> <p>The FSA does not outsource inspections or investigations to other parties. It does, however, make use of its ability under FSMA s.166 to require a “skilled person” report. The FSA will require a firm to commission an s.166 report from an independent third party with specialized knowledge and skills in a particular area. The FSA must approve the person chosen, and the scope of the assignment. The skilled persons report is used as a supervision and investigation tool; for example if the FSA identifies an area of concern, it will require a skilled persons report, leading to recommendations that are either remediated in supervision or become the basis for further investigation in an enforcement action. The FSA does not have express access to the information gathered and used by the skilled person, although it could use its general powers to gather the information directly.</p> <p>The FSA may also appoint a third party to conduct an enforcement investigation on its behalf under ss. 167/168 FSMA, although it rarely does so. The FSA sets the scope of the investigation, the period during which it is to be conducted, how it is conducted and reported. In particular, the FSA may confine the investigation to particular matters, extend it to additional matters, and require the investigator to discontinue the investigation or to take specified steps and to make interim reports. The investigator must also make a report of the investigation to the FSA.</p> <p>Skilled persons and investigators appointed under these sections of the FSMA are subject to the same confidentiality provisions that apply to the FSA (s.348).</p>
Assessment	Fully implemented
Comments	
Principle 9. The regulator should have comprehensive enforcement powers.	
Description	<p>The FSA has broad powers to investigate and bring enforcement actions, including both administrative and criminal proceedings. The FSA can also apply to court for various civil remedies, including orders restraining the contravention of regulatory requirements, restraining a person from disposing of assets, and a restitution order.</p> <p>Administrative sanctions</p> <p>The FSA has the power under the FSMA to impose a range of administrative sanctions for breaches of its rules, including breaches of rules relating to securities and market abuse. These sanctions include the power to censure firms and individuals through public statements, impose financial penalties, withdraw a firm’s authorization, prohibit an individual from operating in financial services, prevent an individual from undertaking specific regulated activities, suspend a firm for up to 12 months and an individual for up to two years from undertaking specific regulated activities, and to require an authorized firm to make restitution.</p>

	<p>The FSA has the power under the FSMA to suspend or prohibit the trading of securities (s.89). The FSA can also take other appropriate action, including issuing a public censure or imposing a financial penalty.</p> <p>Criminal sanctions</p> <p>The FSA has the power to prosecute firms and individuals who undertake regulated activities without authorization. The FSA also has the power to prosecute any person for the criminal offence under FSMA s.397 of making a misleading statement or engaging in misleading practices. The FSA also has powers under the FSMA to prosecute a range of criminal offences, including insider dealing and a breach of the Money Laundering Regulations. Under FSMA s.177, failure to respond to an investigator’s questions or provide information or documents may be treated as a contempt of court, subject to imprisonment and/or a fine. Under FSMA s.398 it is also a criminal offence to provide false or misleading information to the FSA.</p> <p>The FSA also has civil enforcement powers under the Money Laundering Regulations.</p> <p>Investigative powers</p> <p>An investigator appointed under s.167 or s.168 of FSMA (normally a staff person but occasionally a third party) has broad powers to collect information. Section 171 allows the investigator to compel information from any person under investigation or persons connected to him or her. This includes all forms of information and attendance at an interview. Sections 172 and 173 apply this more broadly to any person with relevant information for certain types of investigations (e.g., market abuse).</p> <p>Private remedies</p> <p>FSMA s.71 gives private persons limited rights to bring an action for damages; this right is confined to cases where a person is deemed not fit and proper or who has not been approved performs a controlled function (breaches of ss. 56 (9), 59 (1) or 59 (2)). FSMA s.150 gives a broader right to bring an action for damages for breach of a rule by any authorized persons, specifically excluding rules related to listing, disclosure and transparency of public issues (rules contained in Part VI of FSMA) and rules related to financial resources of an approved person (dealt with under s.71). The High Court case of <i>Hall v Cable and Wireless Plc</i> [2009] EWHC 1793 (Comm) confirms that FSMA does not give investors a private right of action for market abuse and breach of listing rules.</p> <p>Cooperation with other enforcement authorities</p> <p>The FSA has the mandate to directly prosecute criminal matters and does not rely on outside authorities for enforcement of its rules (although criminal matters will be tried in the public criminal courts). However, it shares information with other authorities with some overlapping remit, including the police, the Serious Fraud Office (SFO), OFT or foreign regulators. The FSA has broad powers domestically to obtain information and does not generally rely on other organizations. It is able to obtain information from the above-mentioned agencies. Information sharing powers and practices are set out under Principles 11–13.</p>
Assessment	Fully implemented
Comments	<p>While the FSA has broad powers to compel information from persons not regulated by it, if those persons are connected to a person under investigation, it has a broader power to compel information from anyone for certain investigations (market abuse, etc.). The IOSCO methodology (Key Question 3) states that the regulator should have broad powers to compel necessary information from anyone and does not limit that power to circumstances under which a connection is established. While in practice the FSA has broad powers, where circumstances suggest a specific breach set out in s168 FSMA may have occurred, to compel information from any person regardless of whether they are connected to the person under investigation, the</p>

	authorities should consider broadening FSMA to remove the stipulation that the person must be ‘connected’ in relation to general investigations (where the circumstances do not suggest any specific breach but where the FSA still has concerns).
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>Firm and Regulated Trading Platform Supervision</p> <p>The FSA uses a common risk assessment framework for all regulated entities. All regulated entities have a risk profile (based on size, nature of activities, and markets the firm is active in, governance structure, etc.) that is evaluated against the statutory objectives of the FSA to determine to what extent the firm represents a risk to those objectives (i.e., determining whether, if the firm fails or if the risks identified crystallize, what would be the impact on market confidence, etc.). The frequency and intensity of the review depends on the level of risk associated with the entity measured in terms of impact and probability. The factors taken into account include size and type of activity. Examples of firms determined to be medium to high impact include the large global banking groups, large investment fund managers, futures dealers with complex business operations in derivatives, and spread betting firms that host high frequency ‘day trading.’</p> <p>Firms that range from medium-low impact to very-high impact are subject to an ARROW assessment. The largest firms have a formal ARROW risk assessment every two years, with an interim assessment every year. The RIES, RCHS, and the biggest MTFs have an annual ARROW-style assessment. Some MTFs are operated internally within the larger investment firms and are therefore the responsibility of the supervisor for those entities.</p> <p>Of the 2,059 firms authorized to carry on securities activities or act as investment managers, 91 are placed in medium-to-high impact categories and subject to an ARROW review.</p> <p>Low-impact firms (sometimes referred to as ‘small firms’) are not subject to an ARROW assessment—rather their risk profiles are entered into a risk model along with other information (complaints, market intelligence etc.) that forms the basis for small firm supervision. A small firm assessed as low impact under the risk model is subject to a small firm’s supervisory model. This means they do not have a relationship manager and most contact with the firm is by means of a central contact centre. Some 16,000 firms are in this category and these are a diverse population that includes smaller lenders and insurers, investment, mortgage and insurance intermediaries, and asset managers. The size of these firms encompasses the very small one or two person IFA operations, adviser firms with turnover of less than £20 million, insurance companies with less than £1.8 billion of assets and fund managers with less than £12 billion under management. Over the last three years the FSA has instituted a more intense process of communication and contact with all small firms, including regional seminars and direct face to face or phone contact with each firm to assess understanding and compliance with their regulatory obligations. .</p> <p>The ARROW risk assessment determines the nature and intensity of the supervisory work with respect to that entity including remediation of identified problems or further inquiries. These inquiries can be via discussion with senior management, commissioning of reviews to be undertaken by the firm’s management or a third party (pursuant to Section 166 of the FISMA) and visits led by the supervisory team. The inspection programs also have regard to complaints data collected by the FSA through regulatory returns, customers complaints made directly to the FSA and whistleblower allegations.</p> <p>The FSA has an internal database (IRM) to track and audit supervisory risk assessments and inspection visits. These files are available for inspection by the FSA’s internal quality assurance unit, the Specialist Supervision Unit (SSU) whose role is to provide assurance on the supervisory judgments made, delivery of an appropriate supervisory strategy and overseeing compliance with</p>

supervisory policies and procedures. This unit was established in 2008, and to date, its focus has been on a review of the supervision of high impact firms (HIFs) of which 20 have been reviewed to date. The SSU reports directly to the FSA's CEO. The FSA also has an Internal Audit unit that carries out reviews of all aspects of its operations.

The FSA has initiated an enhancement program for its supervisory (Supervisory Enhancement Program) activities following the financial crisis. The FSA refers to this as the "more intensive and intrusive" supervisory approach which is intended to apply across all its supervisory activities. The SEP is still in the process of being rolled out across the FSA. In the areas relevant to the IOSCO Principles, this has included a focus on client assets and is in the early stages in developing a "core conduct supervisory program." This latter is being piloted in one major institution and it is intended that it will form the basis of a new approach to conduct supervision across relationship managed firms going forward.

Firm compliance program

The FSMA and rules in the FSA Handbook require regulated entities to implement compliance programs relative the scale of their business. For regulated firms the obligations are to comply with its obligations under the FSMA regime and ensure the firm is not used to further financial crime. The responsibility extends to the firm's managers, employees and appointed representatives (or where applicable, tied agents). The FSA has set out rules about regulated firms' compliance functions, including their authority, resources, expertise and access to information, and separation from operational areas.

In relation to employees, in particular, the FSA imposes requirements on senior management at a firm in respect of their management of a firm. If the supervision failures are a result of management's failure to supervise or the firm's poor risk management systems, the FSA may take enforcement action against senior management or the authorized firm.

ARROW inspections include a review of how the firm communicates and trains staff on policies and procedures, and how they monitor compliance with these over time.

For RIEs, the obligation is to adopt appropriate measures to reduce the extent to which their facilities can be used for a purpose connected with market abuse or financial crime and to facilitate detection and monitoring of this conduct. In enforcing or auditing the entities' compliance with these requirements, FSA evaluates the RIE's arrangements, resources, systems and procedures that enable it to monitor the use made of its facilities and obtain information regarding patterns of normal, abnormal or improper use of its facilities.

The FSA also considers whether the RIEs regulatory department is independent from commercial and marketing departments. The FSMA regime imposes specific requirements about record keeping for transactions on authorized exchanges and other trading platforms. RIEs are required to make satisfactory arrangements for recording transactions, which require sufficient arrangements for creating, maintaining, and safeguarding transactions. Investment firms are required to maintain records of transactions they effect in a form that enables the FSA to reconstitute each key stage of the processing of each transaction.

Customer complaints

For investor complaints generally, the core arrangements is the Financial Ombudsman Service (FOS). The FOS is established (by the FSA) as the corporate body for operating the Ombudsman Scheme set out in the FSMA. The Scheme provides for disputes to be resolved quickly by an independent person for complaints relating to financial services (including investment services). The FOS has powers to require information and to determine monetary awards. For complaints about the FSA's exercise of its functions, the FSA has established a complaints handling system in accordance with the FSMA requirements. For the year ended March 31, 2011 the Ombudsman

had 925,095 initial enquiries and complaints and 163,012 new cases referred to its adjudicators and ombudsmen for further dispute-resolution work. Adjudicators resolved 155,591 cases through mediation, recommended settlements, and adjudications. The Ombudsman made 10,730 formal decisions in the relevant period.

Market monitoring and transaction reporting

The RIEs and MTF operators undertake the real time and retrospective monitoring of authorized exchanges and other trading platforms. These entities are required to monitor their markets in real-time as a condition of recognition. These platforms utilize automated and report based systems programmed to identify unusual transactions or trading patterns that may require further investigation. These are referred to the FSA Market Monitoring department markets team for further inquiry and investigation. The FSA supervision process includes a review of the adequacy of the real time surveillance systems of RIEs and MTF operators as part of their supervision of these entities, particularly upon authorization or where there are major upgrades or system changes. The FSA is also currently completing a thematic review of the surveillance systems used by market operators.

The FSA collects transaction reports from investment firms via Approved Reporting Mechanisms (ARMs) on concluded transactions on instruments admitted to trading on regulated venues, as well as a number of specified derivatives linked to such instruments. The FSA is upgrading its transaction reporting systems from its SABRE 2 system and will fully transfer to its new Zen system from April 2011. The new systems will have enhanced capabilities to identify unusual trading patterns, particularly across markets and with link to other market data feeds. Transaction reports must be submitted to the FSA by the end of T+1 and are a consolidated view of concluded cross market trading rather than an order surveillance system for the traded markets.

The FSA indicates it receives approximately 30 million transaction reports per week, from more than 1000 firms. It usually has about 100 preliminary enquiries into unusual or suspicious trading at any one time and around a further 40 investigations into suspected market abuse.

Enforcement program

The FSA has an enforcement program to enforce these regulatory requirements. Under the FSMA, the FSA is legally required to devise and follow a prescribed enforcement procedure (although parts are mandated by FSMA, such as publication of notices). The FSA's enforcement procedure guide sets out the processes including preliminary investigation report, internal decision-making by the Regulatory Decisions Committee, warning notice and decision notice. The FSA's use of mediation and settlement decisions are also covered by the guidance. For reference to the FSA's enforcement powers, information sharing and co-operation arrangements refer to the discussion under Principles 8 and 9 above.

In 2007, the FSA's approach to enforcement changed to place greater emphasis on the role of enforcement in achieving "credible deterrence" in respect of its mandate under the FSMA. In relation to regulation of market abuse and insider trading specifically, the FSA articulated its intent to put criminal prosecutions at the heart of its deterrence strategy and to use civil and criminal powers to tackle tough cases of market abuse.

In the period of April 1, 2009–March 31, 2010, the FSA obtained three criminal convictions for insider dealing which resulted in prison sentences, began proceedings against a further 10 individuals for insider dealing, and conducted major search and arrest operations against suspected organized insider dealers. As at 30 November 2010, the FSA was involved in prosecuting 15 individuals for insider dealing.

From April 1, 2009 to March 31, 2010 the FSA published financial penalties totaling £1.25 million on five individuals for market abuse, censured two (a total of seven Final Notices). During the year, the FSA also commenced investigations into a number of firms for failures in reporting transactions to the FSA, and imposed a financial penalty of £2.45 million on one.

In the period of April 1, 2010–March 31, 2011, the FSA obtained five criminal convictions for insider dealing which resulted in prison sentences, began proceedings against a further five individuals for insider dealing, and conducted a major joint search and arrest operation with SOCA across 16 addresses as part of an investigation into a suspected organized insider dealing ring. As at February 14, 2011, there were 13 individuals awaiting prosecution for insider dealing.

In the period April 1, 2010 to date, the FSA has imposed fines totaling £9.56 million for market abuse. £5.56 million of these were imposed on individuals with a penalty of £4 million being imposed on one firm during the period. A further six transaction reporting failure fines have been imposed, totaling £6.86 million.

In the period of April 1, 2009–March 31, 2010, the Enforcement and Financial Crime Division of the FSA opened 187 cases and closed 172 cases relating to Threshold Conditions (core authorization requirements), and had 31 open cases at the end of the period. In the same period, the Division opened 89 cases and closed 114 cases relating to issues other than Threshold Conditions, and had 173 open cases as at March 31, 2010. These issues include Systems and Controls, Treating Customers Fairly, Unauthorized Activities, Significant Influence Functions (SIF) holders, Market Protection, Listing Rules, Authorizations and Money laundering and Financial Fraud.

The Division opened 271 cases and closed 238 cases as part of its Retail Mediation Activities Return (RMAR) enforcement project, which focuses on ensuring firms comply with the FSA's requirement to submit electronic returns. The project had 41 open cases as at March 31, 2010. The Division also received 781 international requests, and responded to 828 such requests in this period, and had 70 requests outstanding at the end of the period.

Enforcement cases opened and closed in 2009/10

Issue	Open at 01 Apr 09	Opened during year	Closed during year	Open at 31 Mar 10
Systems and controls	41	25	25	41
Treating Customers Fairly	36	23	21	38
Unauthorised activities	15	8	10	13
SIF holders	13	9	6	16
Market protection	25	12	8	29
Listing rules	4	3	2	5
Authorisations	4	3	5	2
Money laundering controls and financial fraud	60	6	37	29
Totals (excl TCT)	198	89	114	173
Threshold Conditions Team (excl RMAR cases)	62	187	172	77
TCT RMAR cases	8	271	238	41
International requests	119	781	828	70

Notes:

1. Cases may include both firms and individuals
2. TCT (Threshold Conditions Team) cases involve regulated firms that fail to meet the FSA's minimum standards i.e. Threshold Conditions
3. The RMAR (Retail Mediation Activities Return) enforcement project began in October 2005 which focuses on ensuring that firms comply with our requirement to submit electronic returns

	<p style="text-align: center;">Referrals and decisions of the Financial Services and Markets Tribunal</p> <p style="text-align: center;">Referrals and outcomes for 2009/10 are recorded in the table below.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2">Type of cases</th> <th rowspan="2">Live</th> <th colspan="3">Outcome</th> </tr> <tr> <th>Tribunal decision</th> <th>Dismissed without substantive hearing</th> <th>Withdrawn</th> </tr> </thead> <tbody> <tr> <td>TCT</td> <td style="text-align: center;">2</td> <td style="text-align: center;">0</td> <td style="text-align: center;">0</td> <td style="text-align: center;">2</td> </tr> <tr> <td>Authorisation</td> <td style="text-align: center;">2</td> <td style="text-align: center;">2</td> <td style="text-align: center;">0</td> <td style="text-align: center;">0</td> </tr> <tr> <td>Market abuse</td> <td style="text-align: center;">7</td> <td style="text-align: center;">5</td> <td style="text-align: center;">0</td> <td style="text-align: center;">1</td> </tr> <tr> <td>Regulatory</td> <td style="text-align: center;">15</td> <td style="text-align: center;">5</td> <td style="text-align: center;">0</td> <td style="text-align: center;">12</td> </tr> <tr> <td>TOTALS</td> <td style="text-align: center;">26</td> <td style="text-align: center;">12</td> <td style="text-align: center;">0</td> <td style="text-align: center;">15</td> </tr> </tbody> </table> <p>Note: This table includes referrals and decisions within the relevant financial year. Some of the cases in which decisions were made were, however, referred in previous years</p> <p>Total number of cases From 1 April 2009–31 March 2010, 25 cases were referred to the Tribunal. This is higher than 2008/09 when 22 cases were referred.</p> <p>Types of cases</p> <ul style="list-style-type: none"> a. TCT: these cases involve regulated firms that fail to meet the FSA's minimum standards i.e. Threshold Conditions b. Authorisation: these cases relate to refusals to authorise firms or to approve individuals c. Market abuse: these cases relate to allegations of market abuse against individuals d. Regulatory: these are regulatory disciplinary cases against authorised firms or individuals <p style="text-align: center;">Source: Appendix 8 of the 2009/10 Annual Report.</p>	Type of cases	Live	Outcome			Tribunal decision	Dismissed without substantive hearing	Withdrawn	TCT	2	0	0	2	Authorisation	2	2	0	0	Market abuse	7	5	0	1	Regulatory	15	5	0	12	TOTALS	26	12	0	15
Type of cases	Live			Outcome																														
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Regulatory	15	5	0	12																														
TOTALS	26	12	0	15																														
Assessment	Broadly implemented																																	
Comments	<p>The FSA's switch to a focus on credible deterrence has, in recent times, started producing clear and significant enforcement results across the range of FSA activities. The internal case selection and management process is clearly linked to its focus of ensuring credible deterrence in areas that the FSA identifies as key priorities for action. FSA enforcement can pursue both civil and criminal prosecutions giving it the flexibility and full range of enforcement tools to take action appropriate to the circumstances. This is an important attribute of the FSA current enforcement approach. The assessors understand this is to be retained in the new regulatory structures. This is something we would strongly support as a change in approach could be disruptive and impede the current momentum.</p> <p>Assessing the effectiveness of enforcement is, to a large extent, judgmental given the lack of any clear agreed methodology or indicators in this area (as the FSA accepts in relation its own efforts to assess effectiveness in this area), and must be assessed in the context of the size and nature of the market under consideration. The assessors note the shift by the FSA to a much clearer focus on credible deterrence over the last few years and importance placed on using a wide range of deterrent actions, including criminal prosecutions for insider trading and other forms of market abuse, in achieving this. While no doubt more can always be done, some good early results are being achieved and there are a number of court actions are in process.</p> <p>Market participants noted it will be a challenge to sustain this current momentum and demonstrate that the FSA can tackle more complex cases of market abuse. The assessors were satisfied that the increase in resources to enforcement in recent years (from 250 to 450 staff persons and evidence of a clear focus on delivery of a credible deterrence outcome is beginning to deliver positive results and having an impact on market behavior and attitudes. This was confirmed by market participants. If the current case load continues to increase over the next few years, the FSA will need to actively review the adequacy of resources as well as ensure the current momentum is not disrupted by the proposed changes to the structure of U.K. regulation.</p>																																	

	<p>In the areas of intermediary supervision, the large number and diversity of the entities, both in terms of size and activities that the FSA has to supervise, poses clear supervisory challenges for the FSA. The FSA uses its common risk assessment process to determine priorities and intensity of supervision and resources across the organization. The FSA is also in the process of changing its approach to what it has articulated to be a more “intensive and intrusive” approach to supervision across all its activities. There is evidence that steps are being taken to implement this new approach throughout the organization, including in the market conduct areas, albeit at different speeds and intensity. Understandably, given the events of the financial crisis, the initial focus for both prudential and conduct regulation has been in the highest impact firms with a particular focus on some key prudential issues.</p> <p>The FSA is in the process of developing a revised core conduct program to reflect this new supervisory approach. To date, this has been piloted in a high impact institution. The FSA has also increased skills, resources and efforts in some key areas relevant to market conduct (and also prudential regulation), particularly in the client asset area. A new specialist unit that has been undertaking intensive work with firms and auditors to enhance standards in this area, given some of the problems with customer asset issues that arose during the crisis. The FSA is also revising its small-firms approach and has confirmed its commitment to continue its work on its Retail Distribution Review reforms in the advisory area.</p> <p>The small firm data driven model of supervision has many strengths for the very small firms. However, given the very wide coverage of over 16,000 firms ranging from the very small IFAs to some not insignificant asset managers and other firms, we had some reservations as to whether the model was equally applicable to all these firms. Further, those firms that fall into the medium impact group are subject to an ARROW review but given the resources available to supervision teams, may not be subject to sufficiently intensive supervision, including sufficiently supplementing the current tow down risk-based model with a greater degree of ‘bottom up’ testing through on-site inspections and verification on a risk basis. The firms in this category would include some important wholesale market participants. For some of these firms a more intensive intermediate supervisory approach appears warranted including some enhanced on-site testing and verification of the robustness of the top-down risk model and the refinement of the supervisory approach for wholesale firms.</p> <p>The assessors also consider that in some cases a number of the new initiatives for more intensive conduct supervision, again understandably, were still at a relatively early stage and efforts in this area continue to be very much work in progress with opportunities for greater cohesion between specialists, supervisors and other parts of the FSA.</p> <p>We therefore rate this Principle as broadly implemented at this time given the need to sustain positive early results from the shift to ‘credible deterrence’, scope challenges, and intensity of supervision across the large and diverse population of firms covered by the FSA’s mandate and its move to more “intensive and intrusive” supervision remains work-in-progress. The assessors acknowledge these are very challenging issues.</p>
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and nonpublic information with domestic and foreign counterparts.
Description	Section 348 of the FSMA creates a general obligation for the FSA to keep information obtained for regulatory purposes confidential. Confidential information is itself described by s.348 as information “ <i>received by the primary recipient for the purposes of, or in the discharge of, any functions of the Authority [and which is] not prevented from being confidential information by subsection (4).</i> ” Section 348(4) allows that information in the hands of a primary recipient is not confidential if it has either been made available to the public, or it is in the form of an anonymized summary or collection of information subject to information sharing through approved “gateways” (essentially exceptions deemed appropriate under the FSMA or a statutory instrument made under it).

	<p>These gateways include the passing of such information between relevant U.K. bodies, e.g., other domestic law enforcement agencies.</p> <p>It is an offence under the FSMA for a primary recipient, or any person who obtains confidential information directly or indirectly from a primary recipient, to disclose confidential information except through statutory gateways or where the originator of the information has given consent.</p> <p>Domestic information sharing</p> <p>The FSA has a duty under FSMA section 354 to take steps, as it considers appropriate, to co-operate with other persons (whether in the U.K. or elsewhere) who have functions similar to that of the FSA or in relation to the prevention or detection of financial crime. Co-operation can and in practice, would include the exchange of information.</p> <p>Cross-border information sharing</p> <p>The FSA may disclose information considered confidential under s.348 FSMA provided the relevant consent has been given or the Disclosure Regulations, commonly referred to as legal gateways, allow it. Under a gateway the FSA could share all information related to Principle 11, Key Question 3 with a foreign regulator. Specifically, under the FSMA a gateway is created for all European Economic Area (EEA) supervisors without the need for a memorandum of understanding. Where non-EEA supervisors are involved, EU directives require that the FSA should have a MOU with the relevant non-EEA supervisor and that confidential information obtained by the FSA as the competent authority under the directives should be disclosed to them only if the jurisdiction has equivalent legal provisions to protect confidential information. The FSA has therefore concluded a number of MOUs with foreign regulators demonstrating equivalency and these serve as acceptable gateways under the FSMA.</p> <p>The FSA is a signatory to the IOSCO Multilateral MOU and the Committee of European Securities Regulators (CESR) Multilateral MOU. It has also agreed a large number of bilateral MOUs.</p> <p>The FSA does not require external permission to share information and can share information under the above-noted gateways even if the alleged conduct is not a breach of U.K. rules. The FSA can share this type of information with foreign regulators.</p> <p>Customer identity</p> <p>The FSA has powers to obtain information relating to securities and derivative transactions and brokerage accounts, including banking information, on its own behalf and on behalf of overseas regulators as defined under FSMA section 195. This information will be confidential (except where, for example, the FSA receives it in summary form such that individual firms cannot be identified) and can only be shared through a gateway, as described above.</p>
Assessment	Fully implemented
Comments	
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.
Description	<p>The FSA has the obligation to co-operate with foreign regulators who have functions similar to the FSA (FSMA s. 354). This includes entering into information-sharing arrangements—whether formal or informal—with another regulator. As described under Principle 11, it has entered into a large number of agreements and two major multilateral agreements. To share confidential information with a regulator in a non-EEA country an information-sharing agreement will only be required for supervisory and civil investigations. Under Disclosure Regulation 4 (the “criminal gateway”), the FSA may disclose confidential information to <u>any</u> person (including outside the EEA) as long as it will be used for the purposes of a criminal</p>

	<p>investigation. Nonconfidential information can be shared with any country, but an agreement is required for the sharing of confidential information with a non-EEA country.</p> <p>Enforcement related information</p> <p>In 2010, the FSA received 892 requests for information from foreign regulators, the majority of these falling under the IOSCO and CESR MMOUs. Of these, 75 percent were requests for transaction data, 10 percent for bank records, and 5 percent for letters of good standing. These information requests are largely handled by enforcement staff. The internal ‘service standard’ for handling of requests is within 12 days, although some requests can take much longer. The FSA is active in the IOSCO Screening Group for the MMOU and is Chair of Standing Committee 4 on Enforcement and Cooperation.</p> <p>Ensuring confidentiality</p> <p>The FSA protects confidentiality of information through the terms of its MOUs and, within the EEA, through EU Directives. The FSA can put restrictions on the use of confidential information by another supervisor and the FSA can require that the other supervisor does not use the information in breach of any restriction without the consent of the FSA. This means that third parties may only onwards disclose the information if there is a permitted gateway for them to do so.</p> <p>Supervisory cooperation</p> <p>The concept of cooperation with foreign regulators is also embedded within the ARROW framework for firms that operate cross-border. The FSA is regularly asked by foreign regulators to issue letters of good standing. The FSA both relies on home regulator advice and undertakes its own due diligence; an applicant will have to demonstrate the equivalency of requirements in the home jurisdiction.</p> <p>The FSA is also part of supervisory colleges for trading platform operators and clearinghouses and has entered into an MOU for many of its RIEs and RCHs that operate cross-border. These MOUs cover detailed operating procedures and agreements on specific sharing of information. The FSA actively cooperates with the US CFTC in the supervision of ICE Europe and with European and US SEC regulators in the supervision of NYSE/Euronext, as two examples.</p>
Assessment	Fully implemented
Comments	
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>The FSA has obligations to provide timely and effective assistance to foreign regulators (FSMA s.354) and also has obligations under the various MOUs mentioned under Principles 11 and 12. Pursuant to s.169 FSMA, the FSA may carry out an investigation on behalf of foreign regulators; this includes the power to request documents and other information and FSA investigators appointed under FSMA s. 169(1) (b) may conduct interviews on behalf of an overseas regulator.</p> <p>The FSA’s assistance would extend to information set out in Principle 13, Key Question 1, including records sufficient to reconstruct transactions (in various markets), client transactions and beneficial ownership in relation to matters set out in Key Question 2, including investigations of insider dealing, market manipulation, misrepresentation of material information, and other fraudulent or manipulative practices relating to securities and derivatives, issuers, market intermediaries, trading systems, and clearinghouses. There are no restrictions on the information that can be shared under an appropriate gateway, subject to EU directives.</p> <p>The FSA also has the power to permit representatives of overseas regulators to attend and participate in any interviews conducted on their behalf. The FSA will do so only if it is satisfied</p>

	<p>that any confidential information disclosed in the course of an interview will be subjected by the overseas regulator to the same level of confidentiality applicable to the FSA.</p> <p>The FSA can provide some assistance to foreign regulators in connection with the making of applications to U.K. courts. However, the FSA cannot generally make an application for a court order on behalf of a third party absent the FSA having its own interest in them application. The FSA's ability to appoint an investigator on behalf of a foreign authority was recently upheld by the Court of Appeal (<i>FSA vs. Amro and Creon</i>) [2010] EWCA Civ 123.</p> <p>The FSA's general policy is to share the type of information on financial conglomerates described in Principle 13, Key Question 7, including information related to the structure of the conglomerate, capital requirements, intra-group exposures, governance, and internal controls. The ARROW framework includes a home/host relationship analysis and anticipates this sharing of information.</p>
Assessment	Fully Implemented
Comments	
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>The U.K. operates substantial primary and secondary equity markets. The London Stock Exchange remains the predominant market for the initial admission of listed shares. At end-September 2010, it had 1,101 U.K. companies and 328 foreign companies listed on its main market, and 1,204 companies (including 224 foreign companies) admitted to its AIM market for SMEs (originally known as the Alternative Investment Market). At September 30, the listed U.K. companies had a market value of £1.82 trillion and the AIM companies (U.K. and foreign) of £65.6 billion.</p> <p>Listing and admission to trading</p> <p>Publicly-traded securities must be listed. Admission to listing on the Official List maintained by the U.K. LA (FSA) is regulated by Listing Rules. The Official List is the list of all securities that have been admitted by the U.K. LA and is maintained in accordance with Section 74(1) of the FSMA. The requirements for securities that are admitted to trading on a regulated market (i.e., London Stock Exchange) are provided by the Prospectus Rules and Disclosure and Transparency Rules.</p> <p>Securities that are admitted to listing on the Official List are 'listed' securities, and those that are listed and admitted to trading are 'traded' securities.</p> <p>The Listing, Prospectus and Disclosure and Transparency Rules implement EU Directives, i.e., the U.K. regulations for public offers are set by the EU Prospectus Directive (PD) and implemented via the U.K. Listing Authority's Prospectus Rules (PR); disclosures and reporting obligations for issuers of publicly listed and traded securities are set by the Transparency Directive and Article 6 of the Market Abuse Directive. CESR has published recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses in order to facilitate the understanding of certain disclosure requirements without imposing further obligations on issuers.</p> <p>The Listing Rules establish a regime that identifies whether issuers of listed securities comply with the minimum standards set by EU Directive or with additional higher standards set by the FSA (super-equivalent standards).</p> <p>Issuers are eligible a 'standard' listing if they comply with the EU minimum standards and they are eligible for a 'Premium' listing if they comply with super-equivalent standards. The FSA has</p>

	<p>taken steps to segment its listings more clearly in 2010. Changes were also introduced to increase corporate governance standards for “Premium” overseas companies by requiring them to comply with the U.K. Combined Code on Corporate Governance in the same way as U.K. premium issuers and to offer pre-emption rights, and to extend the company reporting and statutory audit directives to overseas issuers.</p> <p>Prospectus</p> <p>Under the Listing Rules, an issuer is required to produce a prospectus before its securities are admitted to the Official List, and which is approved by the U.K. LA, unless the offer qualifies as an ‘exempt offer to the public.’ These rules apply to standard and premium listed issuers. Any person who contravenes these rules can be imprisoned for up to two years, or fined, or both. Exemptions include:</p> <p>Offers made only to qualified investors; Offers made to fewer than 100 nonqualified investors per European Economic Area (EEA); The minimum consideration is at least €50,000; or The total consideration does not exceed €100,000.</p> <p>The PD has been reviewed and an amending directive has been published. Many of the exemptions have been amended (e.g., the exemption will apply to offers of up to 150 persons per EEA area, up from 100 persons, and the threshold for minimum consideration will be raised to €100,000). This will be implemented in the United Kingdom by July 1, 2012.</p> <p>The prospectus must contain all necessary information to enable investors to make an informed assessment of the assets, liabilities, financial position, profits and losses and prospects of the issuer and any guarantor. In accordance with the PD, recent financial information and other timely information about the entity’s key investments, future commitments, business activities and revenue trends are required to be included. It must be presented in a comprehensible and easy to analyze form. It must also include a summary, in nontechnical language, that conveys the essential characteristics of, and risks associated with the issuer, any guarantor and the issue. The summary should not exceed 2,500 words and the content of the summary is prescribed. Regulations provide for the minimum information to be included in a prospectus. For issuers within the EU, the Prospectus Directive (PD) and Regulations are applicable as the EU standard. For third-country issuers (outside the EU) the prospectus is required to be PD-compliant in order to obtain FSA approval.</p> <p>If there is an insufficient level of compliance with requirements applicable to prospectus disclosures, the U.K. LA can refuse to approve the prospectus, effectively halting the transaction. Under Rule 5 of the LR, the FSA may suspend listing if the issuer has failed to meet its continuing obligations for listing, failed to publish financial information, or there is insufficient information in the market about a proposed transaction, etc. In addition, under Section 89L of the FSMA, the FSA has the power to suspend for breaches of the transparency rules. Finally, any breaches of the rules can be referred to the FSA’s Enforcement Department.</p> <p>After a prospectus has been approved by the FSA, it must be filed with the FSA and made available to the public as soon as practicable and at a reasonable time in advance, and at the latest at the beginning, of the offer or the admission to trading of the securities involved. The issuer or responsible person must submit a supplementary prospectus containing details of the factor for FSA approval if a significant new factor, material mistake or inaccuracy relating to the information included in a prospectus arises or is noted after the prospectus has been approved and either before the end of the offer period or before trading begins. The supplementary prospectus must be prepared and submitted as soon as practicable after the new factor arises or is noted (Rule 3.4 of the PR).</p>
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Periodic reporting

Reporting requirements for issuers are set out under U.K. company law (the body of rules concerning corporations formed under the *Companies Act 2006 (CA)*), which broadly require all active U.K. incorporated companies to publish annual reports. Additional reporting is required under the Prospectus Rules and the Disclosure and Transparency Rules (DTRs).

Under the Prospectus Rules, issuers with equity transferable securities admitted to trading in the United Kingdom, and in relation to whom the United Kingdom is the home state, are required to prepare a document at least annually that refers to all information that has been published or made available to the public in the previous 12 months (an annual information update). This requirement will be abolished under the amended Prospectus Directive, being implemented in the United Kingdom by July 1, 2012.

The Disclosure and Transparency Rules require periodic financial reporting for any issuer admitted to trading on a regulated market whose home state is the United Kingdom. Chapter 4 (as well as Chapters 5 and 6) of the DTRs implement the EU Transparency Directive (TD) on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market. The TD also deals with the mechanisms through which this information is to be stored and disseminated.

The Disclosure and Transparency Rules requires issuers to produce an annual financial report, half yearly financial report and interim management statement. Issuers also have continuing obligations to disclose specified information.

An issuer (with traded securities whose home state is the United Kingdom) must make public its annual financial report at the latest four months (six months for wholesale debt or professional securities market) after the end of each financial year, and must ensure it is publically available for at least five years. It must include the audited financial statements prepared in accordance with International Financial Reporting Standards (IFRS), a management report and a responsibility statement.

The management report is required to include an assessment of developments and performance of the issuer's business during the financial year, including information about important events since the end of the financial year, dealings in own shares, use of financial instruments, and financial risk management objectives and criteria. In addition, a premium listed company must include in its annual financial report additional information above the requirements set out in Rule 4.1 of the DTR. The additional disclosure requirements include, amongst others, details of related-party transactions (note standard listed issuers are explicitly required to disclose related-party transactions in half yearly financial reports), details of any arrangements under which a shareholder has waived or agreed to waive any dividends, and details of any contract of significance under review. In addition, if the listed company is incorporated in the United Kingdom, additional information under Rule 9.8.6 of the LR must be included, which include director's dealings, all specified acquisition and disposal disclosures made by the company, and statements on going-concern and corporate governance, among others.

The annual report must also contain information about corporate governance within the director's report. This will provide information on its corporate governance code and how it complies with this; a statement setting out its internal controls and risk management systems in relation to the financial reporting process, the composition of its administrative, management, and supervisory bodies; and any information it is required to make available under the Large and Medium-sized Companies and Groups Regulations.

An issuer must make public a half-yearly financial report covering the first six months of the financial year as soon as possible, but no later than two months after the end of the period to which it relates, and ensure it remains public for at least five years. The half-yearly report should

include a condensed set of financial statements, an interim management report and responsibility statements.

In addition to the annual and half-yearly financial reports, an issuer is also required to provide two interim management reports per financial year, one during the first six-month period of the financial year and another during the second six-month period. Rule 4.3.2 of the DTR requires this statement be made between 10 weeks after the beginning, and six weeks before, the end of the relevant six-month period. The interim management statements must contain information that covers the period between the beginning of the relevant six-month period and the date of publication of the statement.

However, if an issuer publishes quarterly financial reports, this will be taken as satisfying the requirement to prepare interim management reports. Quarterly financial reports may be prepared in accordance with national legislation, the rules of the regulated market or of the issuer's own initiative.

Ongoing reporting and notices to securities holders

In addition to the U.K. company law, which obliges most large U.K. companies to hold annual meetings, give notice of meetings, and permit voting by proxy, an issuer must disclose regulated information to the public via a regulated information service (RIS) in compliance with the standards contained in Rules 6.3.4 to 6.3.8 of the DTR. Regulated information should be disseminated to as wide a public as possible and as close to simultaneously as possible in the home member state and in other EEA states. Regulated information is defined as all information that an issuer is required to disclose under the Transparency Directive, Article 6 of the Market Abuse Directive (2003/6/EC) (MAD) and the LR. Listed companies are required to notify an RIS of shareholder resolutions.

For Premium listed issuers, the Listing Rules also require shareholder votes on matters where a vote would not be required by company law, such as on large acquisitions and disposals and related-party transactions (in comparison, standard listed issuers are required to disclose information about related-party transactions and other important events). The rules require a circular to be sent in relation to all matters where a shareholder vote is required. Shareholders are notified of certain transactions and have the opportunity to vote on larger proposed transactions, depending on the 'class' into which the proposed transaction falls. A transaction is classified by assessing its size relative to that of the listed company proposing to make it, using percentage ratios known as class tests. The four key tests are:

The gross assets test = (gross assets subject of the transaction/gross assets of the listed company)%

The profits test = (profits attributable to the assets the subject of the transaction/profits of the listed company)%

The consideration test = (consideration for the transaction/market value of all the ordinary shares of the listed company)%

The gross capital test = (gross capital of the company or business being acquired/gross capital of the listed company)%

The transactions are then classified on the basis of these tests as follows:

All ratios below 5 percent - Class 3 Transaction

Any ratio greater than 5 percent but all less than 25 percent - Class 2 Transaction

Any ratio is greater than 25 percent - Class 1 Transaction

Any percentage ratio is 100 percent or more – Reverse Transaction.

	<p>In particular, the company must notify an RIS as soon as possible after the terms of any of these transactions are agreed, including in the announcement the amount of securities to be issued, details of the transaction and the value of the consideration or gross assets acquired, whichever is the greater.</p> <p>Class 2 transactions require more specific disclosure requirements, including the profits attributable to the assets that are the subject of the transaction, details of key individuals, the effect of the transaction on the listed company, and a description of the business carried on.</p> <p>Class 1 and reverse transactions require shareholder approval and the listed company must send out a circular that has been approved by the U.K. LA and any significant decisions in the transaction must be conditional on the shareholder vote. All circulars must contain the information set out in Rule 13.3 of the LR, which includes, amongst others:</p> <p>A clear explanation of the subject matter, its essential characteristics, benefits, and risks;</p> <p>Why the security holder is being asked to vote and all the information necessary to allow them to make an informed decision; and a recommendation from the Board as to the voting action of security holders.</p> <p>Class 1 circulars must also include a declaration from the directors of the company accepting responsibility for the information in the document, a statement that the information is in accordance with the facts and does not omit anything likely to affect the import of such information, and financial information. Transactions with related parties require shareholder approval under Rule 11 of the LR and must include disclosure in the related party circular. Some of the requirements in the circular mirror the requirements under the PD Regulations, for example, major shareholders, significant changes and material contracts.</p> <p>There are specific requirements regarding the disclosure of relevant information to the market for any issuer admitted to trading on a regulated market or is the subject of an application for admission to trading on a regulated market. These rules implement the Market Abuse Directive. If the issuer is involved in a matter that also falls within the scope of the <i>Takeover Code</i>, Rule 2 of the DTR must also be complied with.</p> <p>Disclosure of inside information</p> <p>An issuer must notify an RIS as soon as possible of any inside information that directly concerns the issuer. Inside information is defined as information that would, if generally available, be likely to have a significant effect on the price of the qualifying investments or the price of related investments. Inside information also must be available on the issuer's internet site (if they have one) by the close of the business day following the day of the RIS announcement. If the rules of another regulated market or overseas stock trading platform operator require an issuer to disclose inside information at a time when an RIS is not open for business, it should disclose the information at the same time as it is released to the public in other jurisdictions in accordance with Rule 1.3.6R of the DTR. Where there is press speculation or market rumour, the issuer should assess whether a disclosure obligation arises by assessing whether the speculation has given rise to a situation whether the issuer has inside information.</p> <p>Advertisements</p> <p>The U.K. LA's LRs apply to any issuer wishing to have its securities admitted to the Official List of the U.K. LA and have them traded on a regulated market. All securities (premium or standard listing) must comply with EU minimum requirements, which include, among others, that the issuer must be duly incorporated or otherwise validly established, securities must conform with the law of the applicants place of incorporation, be admitted to trading on a regulated market, be freely transferable, the whole class of shares must be listed and a prospectus must be approved by the FSA and published for the offering of the securities.</p>
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	<p>An advertisement relating to an offer or admission to trading must not be published unless:</p> <p>The prospectus has or will be published and the advertisement indicates where investors can obtain a copy;</p> <p>It is clearly recognizable as an advertisement; and the information is accurate and not misleading and is consistent with the information contained in the prospectus.</p> <p>Advertisements may be disseminated to the public by interested parties via specific means of communication, such as printed matter, catalogue, radio, electronic mail, fax, television, etc. This is a non-exhaustive list. Rule 3.3.4 of the PR notes that any information concerning an offer disclosed in oral or written form (even if not for advertising purposes) should be consistent with the information in the prospectus.</p> <p>Derivatives</p> <p>The FSMA (Recognition Requirements for Investment Exchanges) Regulations 2001 (Recognition Requirements Regulations) implement parts of MiFID relevant to regulated market operators. It also copies out similarly relevant parts of the directly applicable MiFID Regulation. The Recognition Requirements Regulations provide that an RIE must have rules that ensure that all contracts for derivatives admitted to trading on a regulated market operated by the RIE are designed so as to allow for their orderly pricing, as well as for the existence of effective settlement conditions.</p> <p>In particular, Article 37 of the MiFID Regulation provides that regulated markets need to verify that the following conditions are satisfied:</p> <ol style="list-style-type: none"> i. - the terms of the contract establishing the financial instrument must be clear and unambiguous, and enable a correlation between the price of the financial instrument and the price or other value measure of the underlying security or asset; ii. - the price or other value measure of the underlying security or asset must be reliable and publicly available; iii. sufficient information of a kind needed to value the derivative must be publicly available; iv. the arrangements for determining the settlement price of the contract must properly reflect the price or other value measure of the underlying; and where the settlement of the derivative requires or provides for the possibility of the delivery of an underlying security or asset rather than cash settlement, there must be adequate arrangements to enable market participants to obtain relevant information about that underlying, as well as adequate settlement and delivery procedures for the underlying. <p>For specified financial instruments under MiFID (see below), the requirement for the price or other value measure of the underlying be reliable and publicly available does not apply if the following conditions are satisfied:</p> <ol style="list-style-type: none"> i. The contract establishing that instrument must be likely to provide a means of disclosing to the market, or enabling the market to assess, the price or other value measure of the underlying, where the price or value measure is not otherwise publicly available; ii. The regulated market must ensure that appropriate supervisory arrangements are in place to monitor trading and settlement in such financial instruments; and iii. The regulated market must ensure that settlement and delivery, whether physical delivery or by cash settlement, can be effected in accordance with the contract terms and conditions of those financial instruments. <p>Financial instruments include, broadly, options, futures, swaps, forward rate agreements and any other derivatives relating to commodities that: can be settled in cash; may be physically settled</p>
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	<p>provided that they are traded on a regulated market and/or an MTF; can be physically settled and not being for commercial purposes have the characteristics of other derivative financial instruments; or are contracts relating to climatic variables, freight rates, emission allowances or inflation rates, or other official economic statistics that can be settled in cash.</p> <p>The derivatives trading platforms publish information on contract specification, process of clearing, physical delivery and the nature of their futures and options contracts.</p> <p>For example, the London Metal Exchange provides contract specifications that include summary information for all metals futures, traded options and traded average price options. There are also more detailed contract specifications for each individual metal. The LME website also explains that Exchange is a principal-to-principal market for experienced market operators, not retail clients as well as the market being a “delivery point of last resort” which provides opportunities for financing the physical commodities in times of excess supply and sourcing physical commodities in times of excess demand, while not being a permanently reliable source of metal. The exchange does not publish information on gearing or leverage of market participants.</p>
Assessment	Fully Implemented
Comments	<p>The U.K. regime has a comprehensive regime for the full, accurate, and timely disclosure of financial results and other information that is material to investors’ decision set out in U.K. financial services law, company law and the U.K. Listing Regime listing based on the relevant EU directives. For premium listings and in some other areas, the U.K. requirements are super-equivalent and incorporate additional requirements over EU minimum requirements. The U.K. LA, which is part of the FSA, plays an active role in monitoring the market to ensure U.K. listed companies meet disclosure requirements. A 2010 survey indicated that nearly all market users rate the U.K. LA highly in terms of monitoring compliance with the continuing disclosure obligations.</p>
Principle 15.	
Holders of securities in a company should be treated in a fair and equitable manner.	
Description	<p>Shareholders have comprehensive rights and entitlements under the U.K. securities and corporate law regimes.</p> <p>Appointment</p> <p>U.K. company law requires shareholder votes to appoint and remove directors. The rules for appointing directors are set out in a company’s constitution. By default, in a public company, a new director can be appointed by ordinary resolution (50 percent vote of shareholders) or by a decision of the directors. Each director must resign every three years and may put themselves forward for reappointment by the shareholders. Under the U.K. Corporate Governance Code, all shareholders have the right to elect their directors (under the LR, all listed companies must disclose their level of compliance with the Corporate Governance Code).</p> <p>General meeting and voting</p> <p>A general meeting of a private company must be called by giving at least 14 days’ notice. A general meeting of a public company must be called with at least 21 days’ notice (for an AGM) or 14 days. In line with the Shareholders’ Rights Directive, a quoted company must give 21 days’ notice of a general meeting. A quoted company is only permitted to give 14 days’ notice about a general meeting if the meeting is not an AGM, if shareholders can appoint proxies by means of a website, and if a special resolution at the previous AGM has so agreed (‘quoted’ securities are admitted to trading but not listed on the Official List). U.K. company law provides for voting by proxy or corporate representative. In relation to companies whose securities are admitted to trading on a regulated market, shareholders and debt securities holders must not be prevented from exercising their rights by proxy. The issuer must make available a proxy form on paper, or where applicable by electronic means, to each person entitled to vote at a meeting of shareholders (including intermediaries such as custodians). The proxy form must be made available either together with the notice concerning the meeting or after the announcement of the meeting.</p>

Voting decisions

Company law requires at least the general nature of the business to be conducted at a general meeting of a traded company to be set out in a notice. In addition, there are often specific disclosure requirements depending on the nature of the business to be conducted (for example, in relation to the removal of a director). The LRs require a listed company to produce an explanatory circular for all but the most routine business and also require certain specific disclosures in relation to votes on matters such as authorising repurchases of shares, authorising increases in share capital, dis-applying pre-emption rights, and capital reductions. Furthermore, under the LRs (for Premium listed companies), transactions are class tested to determine whether they require shareholder approval. Any Class 1 or reverse transactions require a circular be sent to shareholders to obtain their prior approval for the transaction. Explanations of Class 1 and reverse transactions are provided under Principle 14.

In addition, if the transaction involves an acquisition or disposal of real property or an unlisted property company, the Class 1 circular must include a property valuation report. Similarly, if the transaction involves the acquisition or disposal of mineral resources, the circular must include a mineral expert's report. Finally, if the transaction relates to the acquisition of a scientific research-based company or related assets, the Class 1 circular must contain an explanation of the transaction's impact on the acquirer's business plan and certain additional information required by the LRs.

For premium listed issuers, transactions with 'related parties' of a certain size must also be subject to shareholder approval. Rule 13.6.1 of the LR sets out the information required to be included within the circular. If voting or other action is required, Rule 13.3.1(3) of the LR requires the inclusion of all information necessary to allow security holders to make a properly informed decision. The disclosure requirements are modelled on the PD regulations and include material information such as major shareholders, material contracts, and related-party transactions. Standard listed issuers are required to disclose information about related-party transactions and important events, under DTR but are not required to seek shareholder approval.

Changes to security holders' rights and constitution

A change to the terms and conditions of a company's securities would require amendments to their articles of association that would require shareholder approval under the CA. In addition, should a company with a Premium Listing amend the terms and conditions of their shares such that their securities are no longer capable of complying with the LRs applicable to a premium listed issue they will require shareholder approval to move to a 'Standard' Listing under the LR (by comparison, Standard listed issuers do not require shareholder approval to move to a Premium listing). Rules 10 and 11 of the LR govern significant transactions and transactions with related parties for Premium listed issuers that may require shareholder approval. In particular, transactions of a certain size and/or nature require shareholder approval. By comparison, standard listed companies are required to disclose important events and related-party transactions.

A company can change its constitution by special resolution (75 percent vote of shareholders). However, no shareholder is bound against their will by any change that increases their number of shares or the amount for which they are liable for their shares.

Where there are two or more classes of shares, the rights attached to a class can be varied only with the agreement of three-quarters of the class, or a special resolution of the class.

Treatment of securities holders

U.K. company law requires transfers of shares to be registered in accordance with the company's articles of association. Registration of a transfer of shares must be as soon as practicable (s. 771 of the CA). CREST ensures that registration is within minutes of transfer of uncertificated shares.

	<p>Remedies are available to protect shareholders from oppression. Both the CARD (for listing) and the MiFID (for admission to trading on a regulated market) require securities to be freely negotiable—in practice, this means very few restrictions on registration of transfers are permitted for traded companies.</p> <p>U.K. company law provides remedies to protect shareholders from oppression. The duties of directors are owed to the company (s.170 of the CA), and in the event of breach of duties, the company can take civil action against a director (s. 178 of the CA). If the company does not take action, any shareholder can bring a derivative claim against the director on behalf of the company (s. 260 of the CA). If the company’s affairs are being conducted in a way that is unfairly prejudicial to all or part of the members, there is a separate right for an affected member to apply to the court for protection (Section 994 of the CA).</p> <p>Under the Listing Principles, a listed company with a Premium Listing must act with integrity toward holders and potential holders of its listed equity shares. The U.K. Insolvency law provides a detailed and comprehensive scheme for dealing with the assets and liabilities of failed companies in a manner that respects the rights and rankings of creditors and shareholders. The overarching Listing Principle 5 applies to every listed company with a Premium listing of equity shares. The principle states that the company must ensure it treats all holders of the same class of its listed equity shares that are in the same position equally in respect of the rights attaching to such listed equity shares. An issuer of shares or debt securities must ensure equal treatment for all holders of shares that are in the same position, and for all holders of debt securities ranking <i>pari passu</i> in respect of all the rights attaching to those debt securities. In addition, under the Disclosure and Transparency Rules, the issuer must publish notices or distribute circulars concerning the allocation and payment of dividends and the issue of new shares, including information on any arrangements for allotment, subscription, cancellation or conversion.</p> <p>Changes of corporate control</p> <p>The Takeover Panel is designated as the supervisory authority for the regulation of takeovers and other change of control transactions in accordance with its rules set out in the Takeover Code. The Takeover Code is designed to ensure that shareholders are treated fairly and are not denied the opportunity to decide on the merits of a takeover and that shareholders of the same class are afforded equivalent treatment by an offeror. The Takeover Code also provides an orderly framework within which takeovers are conducted.</p> <p>The LRs require circulars to be published about takeover transactions. The Takeovers Code contains rules about the general obligation to give the shareholder information; the information must be included in the offer documents and the offeree Board circulars that provide the director’s opinions on the offer and the material changes in the offeree’s trading position and directors’ service contracts. The Code sets out a number of key rules relating to the conduct of the offer process.</p> <ul style="list-style-type: none"> • Rules 23 – the general obligation as to information (the rule requires shareholders be given sufficient information and advice to enable them to reach a properly-informed decision as to the merits/demerits of an offer); • Rule 24 – offeror documents (the rule outlines what information an offeror will be required to include in the offer document. This includes the offeror’s intentions regarding the future of the offered company, its strategic plans, long-term commercial justifications and its intentions with regard to continued employment of the employees and financial information); and • Rule 25 – offeree Board circulars (amongst others, the Board must send its opinion on the offer to the offeree company’s shareholders, the circulars must contain all material changes in the financial or trading position of the offeree company and directors service contracts).
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	<p>General Principle 1 of the Takeover Code requires that all holders of the securities of a particular class must be afforded equivalent treatment. An offer must be open for a minimum of 21 days. If the offer is to be open for acceptances beyond the seventieth day, shareholders must be given 14 days notice of the closure of the bid (Rule 31 of the Takeover Code). The Takeover Code also requires the Board of the offeree company to obtain competent independent advice on the offer and to make the substance of that advice known to shareholders. The Takeover Code set down requirements for the determination of the price of an offer to ensure that all shareholders have the opportunity to share in any premium paid for shares in the offeree company.</p> <p>General Principle 1 also states that if a person acquires control of a company, the other holders of shares must be protected. Rule 9.1 of the Takeover Code requires that a person must make an offer to all other shareholders of the company if he acquires an interest in shares which (taken with shares in which persons acting in concert with him are interested) carry 30 percent or more of the voting rights in a company, or if he (together with persons acting in concert) holds an interest of more than 30 percent but less than 50 percent in the shares of a company and acquires an interest in any other shares which increase the percentage of shares carrying voting rights in which he is interested. General Principle 3 of the Takeover Code states that the board of the offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of a bid. See also Rules 3.1, 21.1, and 21.2 of the Takeovers Code.</p> <p>Substantial shareholdings</p> <p>Under the Prospectus Rules details of major shareholders (defined as any person other than a member of the administrative, management or supervisory bodies who, directly or indirectly, has an interest in the issuer's capital or voting rights which is notifiable under the issuer's national law) must be disclosed. The disclosure must include the identity of the shareholder and the amount of each such person's interest. In addition, disclosure is also required for details of share ownership and options over such shares for members of the administrative, supervisory, or management bodies and any senior manager who is relevant to establishing that the issuer has the appropriate expertise and experience for the management of the issuers business.</p> <p>Persons must notify the issuer if the percentage of the voting rights they hold as shareholders reaches, exceeds, or falls below specified thresholds.</p> <p>For U.K.-incorporated issuers, the notification thresholds are 3 percent, and each 1 percent threshold thereafter through to 100 percent. Certain voting rights are disregarded for this purpose in accordance with Rules 5.1.3 and 5.1.5 of the LR. For non-U.K. issuers, the notification thresholds are set at 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 30 percent, 50 percent, and 75 percent.</p> <p>These persons are required to notify the issuer as soon as possible, but no later than four trading days in the case of a non-U.K. issuer and two trading days in all other cases (Rule 5.8.3 of the DTR).</p> <p>Once an issuer receives such a notice, it is required to notify the RIS. Rule 5.8.12 of the DTR states that an issuer must, on receipt of such a notification, as soon as possible and by the end of the following trading day, make public all of the information contained in the notification. A non-U.K. issuer and any other issuer whose shares are admitted to trading on a prescribed but not regulated market (i.e., in the Alternative Investment Market for SMEs) must, on receipt of a notification, as soon as possible and by the end of the third trading day following receipt of the notification, make public all information contained in the notification.</p> <p>A listed company incorporated in the United Kingdom must also include a statement showing, at the date no more than one month prior to the date of the notice of the annual general meeting, all information disclosed to the listed company in accordance with Rule 5 of the DTR</p>
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<p>The following voting interests must also be disclosed:</p> <p>Voting rights held by a third party with whom a person has concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy toward the management of the issuer in question; and</p> <p>Voting rights held by a third party under an agreement concluded with that person providing for the temporary transfer for consideration of the voting rights in question.</p> <p>In the context of a takeover, the panel code requires a dealing disclosure to the public. If a party to the offer or any person acting in concert with the party deals in relevant securities of any party to the offer, it must make a dealing disclosure by no later than 12 noon on the following business day.</p> <p>Rule 8 of the Takeovers Rules also sets out the disclosure obligations of exempt principal traders and exempt fund managers. Disclosure requirements also apply to the parties to the offer and persons acting in concert with them when they deal for the account of nondiscretionary clients.</p> <p>A person acting in concert with any party to an offer must make a public dealing disclosure if he deals in any relevant securities of any party to the offer (other than a cash offeror) during an offer period for his own account or for the account of discretionary investment clients.</p> <p>A party to the offer and any person acting in concert with it must make a private dealing disclosure if it deals in any relevant securities of any party to the offer (other than a cash offeror) during an offer period for the account of nondiscretionary investment clients, other than a nondiscretionary client that is a party to the offer or any person acting in concert with it.</p> <p>Directors and senior management holdings</p> <p>Persons discharging managerial responsibilities and their connected persons must notify the issuer in writing of all transactions conducted on their own account in the shares and other instruments of the issuer within four business days of the day on which the transaction occurred. The issuer must publish such information to the RIS as soon as possible, and, in any event, by the end of the next business day.</p> <p>Information on share ownership and options over shares in the issuer (at the latest practicable date) must be published for members of the administrative, management or supervisory body and any senior manager who is relevant to establishing that the issuer has the appropriate expertise and experience for the management of the issuers business.</p> <p>Details of any arrangements under which a director of the company has waived or agreed to waive any emoluments from the company or any subsidiary undertakings must be included in its annual report. Rule 9.8.6 of the LR also requires additional disclosure in the annual financial report for a listed company incorporated in the United Kingdom. The additional disclosure must set out all the interests of each person who is a director of the listed company at the end of the financial period under review (i.e., transactions conducted on their own account in the shares of the issuer or other instruments), including changes in the interests of each director that occurred between the end of the period under review and a date not more than one month prior to the date of the notice of the AGM. Many of these requirements stem from the Directors' Remuneration Report Regulations, which came into force on December 31, 2002. The Regulations introduced a requirement that directors of listed companies should produce, for each financial year, an annual remuneration report containing extensive disclosures about directors' remuneration. The report must be put to shareholders for approval by ordinary resolution at the AGM, and it is an advisory vote only.</p>

	For cross-border issuers, a statement is required in the prospectus as to whether or not the issuer complies with its country of incorporation's corporate governance regime. In the event that the issuer does not comply, a statement to that effect must be included together with an explanation. Under revised Disclosure and Transparency Rules, an overseas premium or standard equity issuers will be required to make corporate governance disclosure in the annual report for years beginning after January 31, 2010. These will be required to be audited.
Assessment	Fully implemented
Comments	The U.K. regulatory regime provides shareholders have comprehensive rights and entitlements with protections to ensure that shareholders are treated fairly and equitably.
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>Use of audited financial statements</p> <p>Public companies (here defined as consolidated groups whose equity securities are admitted to trading on a regulated market such as the London Stock Exchange) are required to include audited financial statements in prospectuses and annual reports.</p> <p>Specifically:</p> <p>Prospectuses are required to include audited historical financial information covering the latest three financial years (two years, in some cases) or such shorter period that the issuer has been in operation, and the audit report in respect of each year;</p> <p>Public companies must prepare and public annual financial statements, which must be audited; and</p> <p>If an issuer is required to prepare consolidated financial statements, they must be audited in accordance with Article 37 of the Company Law Directive (83/349/EC), which requires they be audited by one or more persons authorized to audit accounts under the laws of the member state which govern that undertaking.</p> <p>Annual and interim consolidated financial statements for European listed groups are required to apply IFRS as adopted by the EU. The EU IFRS requires financial reports to contain:</p> <p>A balance sheet or statement of financial position;</p> <p>A statement of the results of operations;</p> <p>A statement of cash flow; and</p> <p>A statement of changes in ownership equity or comparable information included elsewhere in the audited financial statements or footnotes.</p> <p>The interim (half-year) financial statements must follow International Accounting Standards (IAS) 34, because the International Financial Reporting Standards (IFRSs), as adopted by European Union, is required for the consolidated accounts of European listed groups.</p> <p>Annual financial reports of all listed U.K. entities are required to be audited under the Disclosure Rules and Transparency Rules of Listing Authority (see http://fsahandbook.info/FSA/html/handbook/DTR/4/1).</p> <p>The Listing Authority can require share registration documents to include audited financial information where an issuer has a complex financial history or a significant financial commitment (see http://fsahandbook.info/FSA/html/handbook/PR/2/3).</p> <p>Setting and enforcement of accounting standards</p> <p>The IFRS Foundation and its standard-setting body, the International Accounting Standards Board (IASB) and the EU endorsement (adoption) mechanism for IFRSs are responsible for</p>

	<p>the establishment and timely interpretation of accounting standards. The IFRS Foundation is an independent, not-for-profit private sector organization working in the public interest.</p> <p>The IASB is responsible for the development and publication of IFRSs, and for approving Interpretations of IFRSs as developed by the IFRS Interpretations Committee, the interpretive body of the IASB. It has adopted a thorough, open, and transparent due process of which the publication of consultative documents and public (webcast) meetings, and engages with stakeholders around the world, including investors, analysts, regulators, business leaders, accounting standard-setters, and the accountancy profession.</p> <p>The IFRS Interpretations Committee has 14 members. Its 14 members are drawn from around the world and are appointed by IFRS Trustees. Its mandate is to review on a timely basis and to provide authoritative guidance (IFRICs) on widespread accounting issues that have arisen within the context of current IFRSs.</p> <p>Enforcement of accounting standards is carried out by the Financial Reporting Review Panel (FRRP) within the U.K. Financial Reporting Council (FRC). The FRC is the United Kingdom's independent regulator responsible for corporate reporting and governance and is not part of the FSA. The statutory backing for the FRC is set out in the CA. The FRC has a range of statutory powers under U.K. company law, and its responsibilities include the duty of oversight over the accounting and auditing professions.</p> <p>The FRRP has responsibility for monitoring financial information and enforcing compliance with relevant reporting requirements, including IFRS. Its scope includes the annual and half-yearly accounts of all public companies and large private companies, which may also be prepared in accordance with the IFRS. The FRRP has the power to take a company to court for an order requiring the Directors to prepare revised accounts. In practice, it achieves its objectives by working with companies on a consensual basis.⁷</p> <p>Audit requirements</p> <p>Audited financial statements are required to be prepared in accordance with the body of audit standards in the United Kingdom. The auditing standards are consistent with the International Standards on Auditing ("ISAs") issued by the International Auditing and Assurance Standards Board (see http://www.frc.org.U.K./apb/publications/ for the standards), which can be regarded as comprehensive. IOSCO issued a statement in relation to the standards in 2009, and as a part of the process the FSA confirmed that the standards are consistent with ISAs, but with some additional requirements.</p> <p>Auditors are required to be independent, in accordance with EU Directive and the ethical standards issued by the Auditing Practices Board (APB). If there is any direct or indirect financial, business, employment or other relationship between the statutory auditor or audit firm and the company that would lead an objective, reasonable and informed third party to conclude the auditor's independence is compromised, the auditor must apply safeguards to mitigate threats to its independence. If the threat is significant, the audit should not be carried out at all. Under Rule 7.1 of the DTR, a listed company must have an audit committee in which at least one member must be independent and at least one member must have competence in accounting and/or auditing. The audit committee must, amongst other things, review and monitor the independence of the statutory auditor and the provision of additional services to</p>
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⁷ The FRRP has reported "To date the panel has succeeded in resolving all cases brought to its attention without having to apply for a court order." (See <http://www.frc.org.U.K./frp/about/>).

the company. The company must base any proposal to appoint a statutory auditor on a recommendation made by the audit committee.

For a U.K. incorporated company with a premium listing, the Rule 9.8.6R of the LR requires the annual report to include a statement of how the company has applied the main principles and relevant codes in the U.K. Corporate Governance Code, one of which deal with auditor independence. Under s. 519 of the CA, when an auditor of a listed company leaves office. It is required to send a “statement of circumstances” to the company and to the appropriate audit authority. The company is required to send a copy of this to every person entitled to receive accounts (e.g., all registered shareholders) within 14 days, or apply to a court if it disputes the statement. Listed companies also have a general obligation to disclose ‘inside information.’

Appointments of auditors are for one year only (s.491 of the U.K. Companies Act 2006). Special notice is required to remove an auditor, which must be done at a general meeting (ss.510 and 511 of the U.K. Companies Act 2006). Notice of the resolution must be given to the Companies Registrar within 14 days. Resignations only require notice by the auditor to the company (ss.516 to 518 of the Companies Act 2006). Irrespective of the reason for ceasing to hold office, the auditor can require a general meeting to be held at which the auditor can be heard (s.519 of the Companies Act 2006). (See <http://www.legislation.gov.UK./U.K.pga/2006/46/contents>)

Setting and enforcement of audit standards

The APB within the FRC is responsible for setting high quality auditing standards and guidance. It issues audit standards which are essentially international audit standards (ISAs) with additional local legal requirements, such as the duty to report to the regulator. The APB also issues ethical standards on the integrity, objectivity and independence of auditors (for example, Ethical Standard 1, *Integrity objectivity and independence*).

The APB has 15 members and observers from the FSA, the U.K. Department for Business, Innovation and Skills, and the Irish Auditing and Accounting Supervisory Authority. It has also established a technical advisory group to advise the body.

The APB offers at least three months public consultation on draft materials and has differing voting requirements for decisions. Decisions to establish, publish, amend, or withdraw a statement of auditing standards or exposure draft, decisions to establish, publish, amend or withdraw nonmandatory notes or guidance require higher majorities than decisions on other questions.

The Audit Inspection Unit (AIU) of the FRC’s Professional Oversight Board (POB) monitors the quality of audits of listed and other major public interest entities, including compliance with auditing and auditor independence standards.

The professional accountancy bodies register firms to conduct audit work with their regulatory activities being overseen by the POB. The audit registration committees of the accountancy bodies receive formal reports from the AIU on its monitoring work, with the POB overseeing the action taken by them in response to the AIU’s findings and recommendations. The AIU undertakes full scope inspections, including a review of firm-wide procedures, annually for the four largest audit firms and over a two-to-three-year cycle for all other firms with more than 10 listed or other major public interest entity audit clients. It undertakes periodic reviews of audits of listed or other major public interest entities undertaken by smaller firms not subject to full scope inspections and oversees reviews of firm-wide procedures undertaken at these firms by the monitoring unit of the relevant professional body. In addition, it selects individual audits for review on a risk basis. The AIU issues a public report on the principal findings of each full scope inspection undertaken, in addition to its more detailed private report to the relevant audit registration committee.

	Financial statements for non-European listed groups are required to be prepared with standards that have been assessed previously as equivalent, including the IFRS, Japanese GAAP, and U.S. GAAP. Prior to financial years starting on or before January 1, 2012, Chinese GAAP, Indian GAAP, and Korean GAAP have also been assessed as equivalent. After this date, these standards will have to be reviewed and reassessed for equivalence by the European Union.
Assessment	Fully implemented
Comments	The United Kingdom has a comprehensive system for the setting of accounting and audit standards in line with the relevant international standards. In addition, there are independent oversight bodies with established audit and review procedures and mechanisms to deal with noncompliance. These bodies (being the U.K. Professional Oversight Board (Audit Inspection Unit) and Financial Reporting Review Panel) regularly publish details of the results of their oversight and surveillance work (see www.frc.gov.U.K.).
Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p>The FSA has full authority to license and supervise asset management firms/fund managers and collective investment schemes. Authorization of collective investment schemes is given in accordance with FSMA and other OEIC Regulations. Regulation of authorized collective investment schemes incorporates the provisions of the UCITS Directive, of which the fourth iteration will become operational in July 2011 (it must be implemented into national law by July 1, 2011). Funds that comply with the UCITS Directive may be marketed in other EU member states. The FSA also makes rules related to collective investment schemes that are marketed and sold in the United Kingdom alone. It also makes rules related to fund managers—these entities are subject to common standards (for example, fit-and-proper requirements, and handling of client money requirements) that apply across all FSA-regulated entities as well as some specific requirements. There is a Collective Investment Schemes (COLL) section of the FSA Handbook containing most of the relevant rules.</p> <p>Funds</p> <p>Collective investment schemes in the U.K. fall into four groups: UCITS eligible funds, governed by EU legislation and which can be passported throughout the European Union, non-UCITS funds (NURS) offered for retail sale in the United Kingdom only and funds available to qualified investors (QIS) and unauthorized funds (such as alternative funds). Closed-ended funds generally take the form of investment companies that are not governed by UCITS or collective investment schemes rules, but are subject to the rules governing public offerings, listing, and the admission of securities to trading on public markets. Investment companies that apply for official listing are subject to specific investment company rules in the U.K. Listing Rules (FSA Handbook Listing, Prospectus and Disclosure LR.15).</p> <p>The marketing and sale of unauthorized schemes is restricted by the FSMA and the Promotion of Collective Investment Schemes (Exemptions) Order 2001. There are specific exceptions: the FSA can recognize unauthorized funds and allow them to be sold to the public, for example, UCITS funds from other EU member states that have complied with a notification process. The notification process requires the UCITS operator to obtain an attestation from the home regulator to confirm that the fund complies with the UCITS Directive. The operator then sends this attestation to the host regulator with copies of the constituting documents of the scheme. The notification process will change with the implementation of UCITS IV in 2011 from which time the initial notification will take place on a regulator-to-regulator basis.</p> <p>The FSA reviews all prospectuses for new authorized funds. The FSA has in place a specialized team that undertakes these reviews according to clearly set out procedures.</p>

Fund managers

All operators of investment funds (investment managers and other financial institutions) must be authorized by the FSA. This includes investment managers that operate unauthorized funds (for example, hedge fund managers). Fund managers are subject to FSA ‘threshold conditions’ (requirements for authorization), including fitness and propriety of key personnel (those conducting significant influence functions—“SIFs”), and adequacy of resources. The fund manager must also meet the FSA Handbook capital requirements, and internal control and systems requirements. In addition, the FSA will specifically review the competence of the manager to carry out the particular kind of business (for example, if the fund manager does not have previous experience in a particular area, the manager will be asked to demonstrate capacity to engage in the new area). The authorization process involves consultation with the investment manager’s senior management and board, and a review of documentation submitted by the applicant firm. When issues of particular concern arise, FSA staff can and do undertake a series of meetings to gather more information.

Fund managers are permitted to delegate functions, but must retain responsibility for compliance with regulations and investment policy. All authorized funds are required to have a depositary, which is responsible for the safekeeping and custody of the scheme assets. The depositary must be separate from the fund manager. Delegation of custodial functions by the depositary is allowed (with notice to the FSA); given recent lessons learned in the Madoff scandal, the FSA is imposing a greater standard of due diligence on depositaries in allowing this sub-delegation. Depositaries have a duty to report certain categories of regulatory breaches by the fund manager to the FSA.

Funds must be audited annually and audit results disclosed in the annual long report of the scheme, which includes a report of the auditor. The auditor is required to comment on whether:

the accounts have been properly prepared in accordance with accounting standard, FSA regulation and the scheme’s constituting documents;

the accounts give a true and fair view of net income and net gains or losses;

proper accounting records have been kept;

the auditor has been given all the information and explanations that are necessary for the purposes of the audit; and

the information in the scheme report is consistent with the accounts.

A fund manager must keep all records for a period of six years. As a condition of authorization, it must report all material changes to its business, organization or rules. The FSA can, if it deems necessary, vary the firm’s authorization should it feel these changes are unfit.

The fund manager is subject to best execution, and fair trading rules set out in the conduct of business and internal controls sections of the FSA Handbook. The FSA Handbook does not permit the fund manager to deal with related parties unless the dealing is carried out on an “arm’s length” basis (that is, on a basis at least as favorable to the fund as a comparable transaction on normal commercial terms negotiated at arm’s length).

Supervision

Once investment managers are authorized, they are given a risk assessment and assigned to a supervision team. The system of supervision is described under Principle 10 and 21 in greater detail. Investment managers subject to the common framework. Investment managers with greater than £8 billion assets under management are subject to the ARROW review (for managers that do not handle client monies directly, the threshold is £12 million). This means only a subset of fund managers have ongoing contact with supervisors. The others fall into the

	<p>small firm category and would not be subject to onsite supervision, for example, unless their activities, complaints about them or financial problems raised their risk profile. The FSA also carries out thematic assessments. For example, following the Lehman collapse and the uncertainties created by comingling of client assets with firm assets, the FSA did thematic reviews of handling of client monies (identifying a number of serious concerns). The FSA did a review of risk-management procedures at several large firms, identifying concerns with capacity to undertake risk management. This resulted in a series of changes at those firms.</p> <p>Investment managers are subject to regulatory reporting requirements, including capital position, and details of customer complaints (a short report is made semi annually and a longer form report annually).</p> <p>Remediation</p> <p>FSMA s. 19 provides that no person may carry on a regulated activity in the United Kingdom by way of business, unless he is an authorized or exempt person (this is known as the “general prohibition”). Together with s. 19, s. 23 prohibits unauthorized person from being involved in the management or promotion of CIS. FSMA s. 23 provides that a breach of the general prohibition is a criminal offence, punishable by up to two years’ imprisonment and/or an unlimited fine. The FSA has taken action through the courts against a number of unauthorized operators of CIS.</p> <p>The FSA also has a broad ability to use its OIVOP (Own Initiative Variation of Permissions) power to impose requirements on the investment manager. For example, an OIVOP order could be used to prevent the manager from taking on new business if the firm if the firm presented a risk. The OIVOP power may be used in circumstances where the FSA considers it is desirable to exercise it in order to meet any of its regulatory objectives, or where the firm is failing or is likely to fail to satisfy the threshold conditions, or, more exceptionally, where the firm has not conducted an activity on its permission for at least 12 months.</p>
Assessment	Broadly implemented
Comments	<p>The Principle (KQ 8) anticipates a system of on-site examinations of fund managers. The FSA does not carry out onsite reviews except for the largest of firms and through thematic reviews. Accordingly, the large majority of firms would not be subject to an onsite examination of the type contemplated under the principle. Given the large number of firms the FSA must regulate, it makes sense to use a risk-based supervision—as there is a systematic approach to determining where it will deploy limited resources. The assessors did not delve into whether the specific risk-based methodology used by the FSA is fully fit for purpose, given the large and diverse population of regulated entities, and its use both to calibrate risk and allocate resources. This would involve a more detailed review. As we have noted under Principle 10 and 21, there are a number of strengths to the supervisory approach, such as in the application of the small-firm methodology to very small firms. However, given the nature, size, and diversity of the regulated population, the assessors had some concerns as to the extent and comprehensiveness of supervisory coverage of mid-size investment managers and the need for the top-down risk approach to be complemented by a more robust bottom up system of testing through on-site examinations and verification. These issues may also involve a review of resources and how they are allocated. We note also the particular emphasis the Methodology gives to on-site examinations for investment managers and, in light of this and the concerns expressed above, have rated the Principle ‘broadly implemented.’</p>
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>Legal form and structure</p> <p>An authorized CIS must be either a unit trust or an Open-Ended Investment Company (OEIC) in accordance with FSMA, the Open-Ended Investment Company Regulations 2001 and the FSA Handbook. The legal form of the fund must be disclosed in the prospectus, which is distributed to investors prior to purchase.</p>

Material changes

Fund operators are required to notify investors/and or seek approval of a variety of changes to the fund. Changes are classified in the FSA Handbook. A fundamental change, which is a change that materially alters the purpose or nature of the fund, increases risk provide or introduces or changes rules governing redemptions, must be approved by unit/shareholder vote.

Where the investment fund manager proposes to make significant change to the fund—a change, which is likely to cause an investor to reconsider participation in the fund—investors must be given not less than 60 days’ before the change takes place. Fund managers must also give investors notice of various other events, as set out in the FSA Handbook.

The FSMA and the OEIC Regulations require that a fund operator must give the FSA notice of its intention to change an aspect (or multiple aspects) of a scheme’s operation and must further notify the FSA once the changes are complete.

Safekeeping and segregation

FSMA and the OEIC Regulations require CIS assets to be held in trust by the trustee (for a unit trust) or by a depositary (for an open-ended investment company). The fund operator and trustee/depositary must be independent of each other (the trustee/depositary must be a bank). The FSA Handbook (COLL 6.6.15R) prevents custodial functions being delegated by the depositary to the CIS operator.

The Handbook (COLL 6.6.6R) requires a fund operator to keep records sufficient to demonstrate and ensure compliance with the regulatory framework for a period of six years. The fund operator must supply these to the scheme’s depositary immediately upon request. The depositary has an obligation to report certain regulatory breaches to the FSA.

As described in Principle 17, the FSA has recently created a specialist team handling issues related to handling of client monies. This team has been involved with supervision on thematic reviews of investment managers.

Audit requirements

The annual report of the fund must include a report of the auditor. The auditor is required to comment on whether:

the accounts have been properly prepared in accordance with accounting standard, FSA regulation and the scheme’s constituting documents;

the accounts give a true and fair view of net income and net gains or losses;

proper accounting records have been kept;

the auditor has been given all the information and explanations that are necessary for the purposes of the audit; and

the information in the scheme report is consistent with the accounts.

Winding up

Procedures of the wind-up of a fund are set out in the FSA Handbook (COLL 7.3 and 7.4). The supervision team in the FSA would lead the wind up with involvement from the authorization team. There is a special unit of enforcement that deals with ‘threshold’ (authorization) conditions. To date there have been no forced wind ups for funds. Staff indicated that funds are commonly wound up or merged by fund managers and this must be approved by the FSA.

Assessment	Fully implemented
Comments	
Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	<p>Offering Disclosure</p> <p>Fund operators must file a prospectus with the FSA and this must be approved prior to marketing the fund to investors. The FSA Handbook (COLL 4.2.5R) prospectus must include:</p> <ul style="list-style-type: none"> • The date of issuance of the offering document; • Information concerning the legal constitution of the fund; • The rights of investors in the fund; • Information on the operator and its principals; • Information on the methodology of asset valuation procedures for purchase, redemption and pricing of units; • Relevant, audited financial information concerning the fund; • Information on the depositary; • The investment objectives and policy of the fund, including permitted assets and investment and borrowing limits; • Information on the risks involved in achieving the investment objectives; • The appointment of any external administrator or investment managers or advisers who have a significant and independent role in relation to the fund; and • Fees and charges to be deducted. <p>A fund operator must, for each fund that it operates, produce a prospectus and either a simplified prospectus or what is known as a "key features document" (depending on the type of fund). Both the simplified prospectus and the key features document are designed to give investors pertinent information in simplified form. There are requirements in place in respect of the content of these documents, and both documents are designed to include all information an investor or potential investor might need to make an informed decision about whether to invest in the scheme.</p> <p>Investors must be given the simplified prospectus or key features document before making an investment. The prospectus is available free-of-charge on request.</p> <p>Marketing materials</p> <p>The Conduct of Business rules (COBS), which apply to all authorized firms, include rules governing financial promotions. Such promotional material should be clear, fair and not misleading. Marketing materials are not reviewed or approved by the FSA.</p> <p>Review</p> <p>The FSA reviews and approves all prospectus and offering documents. This review is done by a dedicated specialized team. The team follows a model of review in place to ensure consistency of treatment. The team emphasizes review of disclosure of suitability of the investment and risk implications. There appear to be sufficient resources in place to effectively handle these reviews.</p> <p>Under FSMA s. 245, the FSA has the power to withhold authorization. Often the review requires several iterations of the application documentation before the process is complete.</p>

	<p>Continuing obligations</p> <p>The FSA Handbook specifies (COLL 4.2.2R) that the fund operator must keep the prospectus up to date. The fund operator is also responsible for ensuring that the prospectus does not contain any false or misleading information.</p> <p>In addition to the updated prospectus, the FSA Handbook (COLL 4.5) requires a fund operator to produce annual and half-yearly long and short reports. The short form report must be sent to each unit holder within four months of the end of each annual accounting period and two months of the end of each half-yearly period. The long report (which contains greater detail including the auditor and depositary reports) must be made available on the same timescales. Both the long form and short form reports must also be available free-of-charge to anyone who requests them. Both reports are filed with the regulator but only the short report must be sent to investors.</p> <p>The fund manager has an obligation to notify investors of any significant changes to the fund or its operations (changes which might reasonably impact the investors decision to remain in the scheme) and to hold a vote on fundamental changes to the fund or its operations.</p> <p>Accounting standards</p> <p>The reports and accounts required by the FSA Handbook must be prepared in accordance with the Statement of Recommended Practice (SORP) issued by the Investment Management Association (a trade group). The SORP contains recommended accounting practices, which supplements general accounting standards. It is approved by the Accounting Standards Board. Accounts prepared in accordance with the SORP should comply with all applicable Statements of Standard Accounting Practice (SSAPs), Financial Reporting Standards (FRSs) and Urgent Issues Task Force (UITF) Abstracts.</p>
Assessment	Fully implemented
Comments	
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Asset valuation</p> <p>The FSA Handbook (COLL 6.3) sets out detailed requirements for valuation of fund assets. Authorized funds must calculate their NAV at least once per month (COLL 6.3.4R (4)) although in practice, most funds carry out daily calculations. The terms and frequency of calculation must be set out in the prospectus and any changes must be approved by investors. The fund operator is required to carry out a “fair and accurate” valuation of the scheme property. The FSA Handbook provides guidance for the valuation of assets (COLL 6.3.6G). It includes guidance on fair value pricing which should be used for any asset where no reliable price is available, for example where a market or trading in an individual stock is suspended. The operator is required, in these circumstances, to value the investment(s) at a fair and reasonable price, giving consideration to the type of fund, the securities involved and the basis and reliability of the pricing method. Fund operators are required to have in place a Fair Value Pricing policy which sets out how fair value pricing will be carried out. Funds must be audited annually and auditors are required to comment on compliance with the valuation policy.</p> <p>Pricing and redemption</p> <p>Funds in the U.K. can use single pricing (with values calculated at the mid price at a pre-defined valuation point.) or dual pricing (pricing the fund at both the bid and the ask price). Under COLL 6.3, if a fund is single-priced, the CIS operator must not sell a unit at a price higher than the unit price plus a fee, or repurchase a unit at a price lower than the unit price less any redemption fee. If a fund is dual-priced, the CIS operator must not sell a unit at a price higher than the offer price, and must not repurchase a unit at a price lower than the price at which the units are cancelled by the depositary. The offer price must not be less than the price which is paid in respect of the issue</p>

	<p>of those units by the depositary. Pricing policy must be included in the prospectus.</p> <p>COLL 6.3.11R requires that unit prices be published in an appropriate manner. COLL 6.3.12G sets out guidance on the manner of price publication. Price publication policy must also be included in the prospectus. In practice, most retail funds publish prices in daily newspapers.</p> <p>COLL 6.3.6G (4) and (5) sets out guidance to be followed in the event of a pricing error. CIS operators should record instances of pricing errors and should notify the depositary. The depositary has an obligation to notify the FSA where the pricing error is material. The depositary is also obliged to report quarterly to the FSA, giving assurance that the fund is in compliance with stated policies. Operators are required to consider appropriate compensation for pricing errors, although the depositary may waive this requirement where the error is less than 0.5 percent and the operator has effective unit price calculation controls. The FSA has reviewed pricing policies and practices as part of a thematic review of a sample of firms and found some discrete issues but no evidence of widespread malpractice in this area.</p> <p>The fund operator has the ability to halt redemptions if it has agreement from the depositary to do so and if it notifies the FSA (COLL 7.2) The rules note this should only happen in extraordinary circumstances and applies to both investments into and redemptions from the fund. The operator must, to the extent practicable, continue to value assets at the frequency disclosed in the prospectus during the period of suspension. The FSA can use its general powers to force an end to the operator's halt to redemption. The operator or depositary must provide the FSA with an update of the suspension every 28 days. (COLL 7.2.1R) The FSA has the power to direct the operator to suspend issuance or redemption of units under FSMA s.257 (2) (a).</p>
Assessment	Fully implemented
Comments	The FSA Handbook contains adequate requirements and guidance on pricing and redemptions. The FSA, in practice, has examined these issues and acted where necessary.
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>The U.K. regulatory regime covers the full range of financial intermediary activity. It contains a general prohibition on the conduct of a regulated activity without appropriate authorization by the FSA. There appear to be no major gaps in scope of entities and activities covered by the FSA in terms of the IOSCO principles and regulation. Compared to many jurisdictions, the FSA has a very broad remit in terms of activities covered under the FSMA.</p> <p>The basic structure of the regulatory regime for intermediaries is that FSMA s.19 provides that no person may carry on a 'regulated activity' in the U.K., or purport to do so, unless he is an authorized person or an exempt person (for example, an appointed representative). Breach of section 19 may be a criminal offence and punishable on indictment by a maximum term of two years imprisonment and/or a fine.</p> <p>The FSMA (Regulated Activities Order) 2001 ('RAO') then sets out those activities that are regulated activities for the purposes of FSMA. These activities include, among others:</p> <ul style="list-style-type: none"> • Managing investments; • Arranging deals in investments; • Dealing in investments as principal; • Dealing in investments as agent; • Advising on investments <p>A market intermediary that proposes to conduct any regulated activities in the U.K. and who is not an exempt person must first obtain authorization to do so and must do so by applying for permission under FSMA Part IV. Such application is made to the FSA and such permission can be made only by the FSA. The exemptions referred to above include a person who is an appointed by the firm. Other exemptions include for a professional firm (i.e., a firm of solicitors, accountants or actuaries) carrying on certain regulated activities that are incidental to its main</p>

	<p>business or a local authority or certain kind of housing body carrying on insurance mediation or mortgage activities</p> <p>Section 41 of FSMA requires the FSA, when giving or varying a permission for a person to carry on a regulated activity, to ensure that ‘the person concerned will satisfy, and continue to satisfy, the threshold conditions in relation to all of the regulated activities for which he has or will have permission.’ The ‘threshold conditions’ are set out in Schedule 6 of FSMA (and the Threshold Conditions (COND) section of the FSA Handbook) and deal, for example, not only with such matters of legal status of the person concerned and, if it is a body corporate, the location of the head office, but also with the transparency of any close links it has with another person, the adequacy of its resources (financial and nonfinancial) and that is a ‘fit and proper’ person. The FSA’s capital, capital adequacy and other prudential rules relating to market intermediaries are set out in the FSA Handbook, specifically the General Prudential Sourcebook (GENPRU) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU).</p> <p>The FSA has a centralised authorization process and an on-line application process. As part of any application for Part IV permission, the FSA assesses the firm based on the information provided in the detailed on-line application packs. The FSA provides detailed guidance on key application information tailored for each type of regulated activity. Where relevant due to the size or nature of the entity, the authorization unit will involve the relevant supervisors in an assessment of an authorization application. Most authorization work is done through off-site review of documentation and meetings with senior management and members of the Board. On-site work at the authorization stage is limited.</p> <p>Certain ‘controlled functions’ within the intermediary, such as director or investment adviser, will require assessment and approval. In order to be approved to perform a controlled function, an individual must satisfy the FSA that he/she can meet, and maintain, the criteria for approval (the ‘fit and proper test’ (FIT)). This is based on the individual’s:</p> <ul style="list-style-type: none"> • Honesty, integrity and reputation; • Competence and capability; and • Financial soundness. <p>In addition, the FSA will consider the intermediary’s controllers that hold a qualifying holding (10 percent or more of the shares or voting power in the intermediary) or effectively direct the business of the intermediary. For high impact firms the FSA has introduced a more intense interview and assessment process for persons wishing to take up controlled functions with a greater focus on testing of competence.</p> <p>Any application for Part IV permission will require the intermediary to set out how it will continue to be in compliance with Senior Management Arrangements, Systems and Controls (SYSC) section of the FSA Handbook.</p> <p>Authority of regulator</p> <p>Where an applicant fails to satisfy the threshold conditions, FSMA s. 52 details that where the FSA proposes to refuse an application for Part IV permission it must issue a warning notice, informing the applicant of the grounds under which the FSA is not satisfied.</p> <p>The FSA has specific powers, set out in Part XII of FSMA (s. 178 onwards), in relation to changes in the control of an authorized firm. These enable the FSA both to attach conditions or and/or restrictions to the acquisition of a controlling interest and not to approve the acquisition of a controlling interest. When the FSA does not approve the acquisition of a controlling interest and the interest has already been acquired, FSMA provides for the FSA to seek a court order requiring the holder of the controlling interest to reduce his holding.</p>
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In respect of a firm's failure to meet relevant requirements, FSMA s.53 (exercise of own initiative power procedure) details the procedures whereby the FSA proposes, on its own initiative, to vary an intermediary's Part IV permission. (Section 45 FSMA sets out the grounds for the use of the power.) Similarly, FSMA s.54 (Cancellation of Part IV permission: procedure) details the circumstances and procedures whereby the FSA proposes on its own initiative, to cancel an intermediary's Part IV permission. Under s.63(1) of FSMA (Withdrawal of approval), the FSA may withdraw its approval, given the particular arrangements, if it considers that the person to whom the approval was given is not fit and proper to perform the controlled function to which the approval relates.

For individuals with a past violation, every applicant is judged on their merits rather than an automatic refusal. Section 56 of FSMA (Prohibition Orders) states that where it appears to the Authority that an individual is not a fit and proper person to perform functions in relation to a regulated activity, it may make an order ('a prohibition order') prohibiting the individual from performing a specified function.

Ongoing requirements

A firm is required to provide the FSA with a wide range of information to enable the FSA to meet its responsibilities for monitoring the firm's compliance with requirements imposed by or under the FSMA. Some of this information is provided through regular reports, including general reporting and transaction reporting. In addition, other chapters in the FSA Handbook set out specific notification and reporting requirements. Principle 11 of the FSA's Principles for Business includes an overriding requirement for a firm to disclose to the FSA anything relating to the firm of which the FSA would reasonably expect notice. SUP 15 of the FSA Handbook requires a firm to immediately report any changes to its ability to meet threshold conditions or any events that might have a material impact on the firm.

Information about licensed intermediaries available to the public:

The FSA maintains a public register, as part of the record-keeping requirements and public access requirements set out in FSMA, Part XXIII (starting at s. 347). The register records all the firms, individuals and other bodies that fall under the FSA's regulatory jurisdiction under the FSMA and the Money Laundering Regulations 2007 and is accessible via the FSA's website. Among other things, the register contains details of the nature of the regulated activities undertaken by the regulated entity.

Monitoring, investigating, and enforcing securities laws and regulations affecting intermediary activities

The FSA has a detailed risk-based approach to the supervision of entities providing intermediaries activities and has in recent time increased the number of enforcement or other actions for breaches by firms in relation to internal controls, transaction reporting requirements, customer assets or money or other important customer protections. It also has the power to ban individuals. As set out in more detail under Principle 10, the assessors considered there were a number of clear strengths to the FSA supervisory approach including in its evolving approach to its small firms supervision, specialist reviews, in areas such as client assets and money, and supervision of the relationship managed mid-sized firms. An authorized firm is required to provide the FSA with a wide range of information to enable the FSA to meet its responsibilities for monitoring the firm's compliance with requirements imposed by or under the FSMA.

Authorized firms are subject to periodic regulatory reporting requirements. These reports are used to assist compile a financial and risk profile information on regulated entities. However, given the nature, size and diversity of the regulated population the assessors had some concerns as to the extent and comprehensiveness of supervisory coverage of mid-size firms across the whole

	<p>population and the need for the top-down risk-based approach to be complemented by a bottom up on site process of verification. (See also Principles 10 and 17.) The assessors also noted that a number of the current developments relating to the FSA's new approach to conduct supervision were still in pilot stage or work in progress.</p> <p>Investment advisers</p> <p>An entity advising on investments must be authorized. An authorized person has to comply with all the requirements for the permissions for which he is authorized. These include all the relevant FSA rulebook provisions for the Conduct of Business and Senior Management Arrangements, Systems and Controls sourcebooks.</p> <p>The FSA rules require firms conducting investment or insurance business to segregate client assets and money belonging to clients from those belonging to the firm. The FSA uses a variety of supervisory tools, including desk-based analysis, on-site supervisory visits and thematic work, to monitor firms' compliance with client-segregation rules, and a number of enforcement actions have been successfully brought against firms that have failed to comply with the rules.</p> <p>The FSA rules require a firm to arrange for orderly records to be kept of its business and internal organization, including all services and transactions undertaken by it, which must be sufficient to enable the FSA or any other relevant competent authority under MiFID to monitor the firm's compliance with the requirements under the regulatory system, and in particular to ascertain that the firm has complied with all obligations with respect to clients.</p> <p>Disclosure to clients</p> <p>The FSA's Conduct of Business Sourcebook sets out a number of disclosures that a firm must make to clients. These include details about the firm, the nature and terms of the services provided, together with information on fees and investment strategies. (See COBS 4 and 6 (COBS)). If arrangements made by a firm to manage conflicts of interest are insufficient to prevent potential damage to a client's interest, the firm must clearly disclose the nature of the conflict of interest before undertaking business for the client (SYSC 10.1.8).</p> <p>FSA rules do not currently require advisers to disclose to their clients their qualifications, industry experience, or disciplinary history. However, details of disciplinary history are available on the FSA public register. The FSA has plans to publish more data about advisers' professional standing from 2013. The FSA is proposing to require that advisers will be required to hold a statement of professional standing from 2013, which can be shown to clients as a means of evidencing an adviser's subscription to ethical standards and professional standards.</p> <p>The rules addressing communicating with clients and financial promotions include rules in respect of fair, clean and not misleading communications and investment performance along with rules requiring arrangements for the management of conflicts of interest and required disclosures of conflicts of interest to clients (SYSC 10). There are also detailed rules relating to segregation and safekeeping of customer assets that apply to any firm that holds client assets.</p>
Assessment	Broadly implemented
Comments	<p>The FSA has detailed authorization and ongoing regulatory requirements covering intermediaries, including for investment advisers. The FSA has appropriate powers to refuse, withdraw or vary an authorization or permission. A firm is required to provide the FSA with a wide range of information to enable the FSA to meet its responsibilities for monitoring the firm's compliance with requirements imposed by or under the FSMA. The FSA does not currently require advisers to disclose to their clients, their qualifications, industry experience or disciplinary history. The FSA has plans to publish more data about advisers' professional standing from 2013. The FSA is proposing to require that advisers will be required to hold a statement of professional standing from 2013 which can be shown to clients as a means of evidencing an adviser's subscription to ethical standards and professional standards.</p>

	<p>The FSA has a detailed risk-based approach to the supervision of entities providing intermediaries activities and has in recent time increased the number of enforcement or other actions for breaches by firms of internal controls, transaction reporting requirements, customer assets or money or other important customer protections. The FSA also uses thematic reviews in key areas to complement its other firm supervisory activities and firms are required to periodically report to the FSA a range of financial and other information.</p> <p>As set out under Principle 10, the assessors considered there are a number of clear strengths to the FSA supervisory approach, such as in the application of its small firms' methodology to the very small firms and some interesting developments in approach to supervision of market conduct currently underway. However, given the nature, size, and diversity of the regulated population, the assessors had some concerns as to the extent and comprehensiveness of supervisory coverage of mid-size wholesale-style firms and the need for the top-down risk approach to be complemented by a more robust bottom-up system of testing and verification. Addressing these concerns may also involve a review of resources and how they are allocated. The assessors also noted that a number of the current developments relating to the FSA's new approach to conduct supervision, while promising, were still in pilot stage or work in progress.</p> <p>There remains a gap in information on professional standing provided to customers until the changes are made in 2013. There are also some challenges in terms of coverage and intensity of supervision, given the size and diversity of firms, and that a number of initiatives to revise the supervisory approach to market intermediaries, the assessors considered the principle to be broadly implemented.</p> <p>The assessors consider that the basic components of a robust, risk-based conduct supervisory regime for market intermediaries are in place and, in some areas such as the small-firm strategy when applied appropriately to very small firms are quite impressive. However, given the size of the regulatory population and current resourcing of the regulators we consider there are some potential gaps in coverage at an appropriate level for some medium sized firms, and the revised approach to a more intensive supervision remains very much work in progress.</p> <p>Going forward, the FCA, as the FSA has itself identified, will need to address how best to develop a supervisory approach suited to wholesale conduct risk for the authorized firms under its remit. To date, the focus of much of the conduct regulation has, for good reason, been largely focused on issues related to product sales to retail customers</p>
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>Investment firms and investment managers in the U.K. are subject to capital requirements set out in the FSA Handbook, which incorporate the standards of the EU Capital Requirements Directive (CRD).</p> <p>Firms are divided into two groups: those that are large and have a full range of activities are subject to both general requirements in the FSA Handbook (GENPRU) and additional requirements (BIPRU).</p> <p>The second set is firms with limited activity: these include firms exempt from the CRD or exempt from investment firm provisions under MiFID. The CRD defines firms that do not hold client monies or assets; do not provide investment services other than the transmission of services and do not borrow or lend to clients as limited activity firms and these are subject to reduced requirements. The requirements for these firms are set out in IPRU (INV), chapter 3 for those within the definition of securities and futures firms, chapter 5 for investment managers and chapter 13 for personal investment firms. The firms that are exempt from definition of investment firm under MiFID are those firms that do not deal for third parties, do not act as market makers or provide investment or commodities services only to a corporate group to which they belong. These are also subject to IPRU (INV) rules.</p>

	<p>Additionally, there are a number of accountants, solicitors etc that are exempted from MiFID under Article 2.1. (c), on the basis that their investment business is incidental to their main professional activity. Their prudential requirements are set out in IPRU (INV) chapter 2.</p> <p>Full service and large firms</p> <p>BIPRU firms are required to hold 8 percent capital against risk-weighted assets, as set out in the Basel II agreement. In practice, the FSA requires additional capital under Pillar 2 of Basel II. BIPRU firms are subject to capital resource requirements calculation (CRR), which is calculated as the sum of the credit risk capital requirement, the market risk capital requirement, and the operational risk capital requirement, and this amount is added to the 8 percent calculation. For certain investment firms (such as small firms that deal on own account and do not hold client money), the operational risk capital requirement is waived. The credit risk capital requirement includes counterparty credit risk and concentration risk. The market risk capital requirement includes risks attached to positions in foreign currencies, options, interest rate products, equities, and commodities.</p> <p>Under BIPRU 12, BIPRU firms are also subject to liquidity standards. BIPRU 12.2.1 requires a firm to maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. In addition, larger investment firms are also subject to the Individual Liquidity Adequacy Standards (ILAS) regime, in which firms are required to ensure that they have a sufficient liquid assets buffer to survive stress tests including a withdrawal of short-term funding for two weeks, a ratings downgrade and loss of access to foreign currency markets which contains a market risk, credit risk and operational risk component. All of these requirements will be reconsidered when additional standards are introduced by the Basel Committee and brought into the CRD.</p> <p>Requirements are calibrated to the level of risk in a firm's portfolio. For firms subject to BIPRU, there is a floor on capital requirements equal to the base capital resources requirement, but above this level, the market risk capital requirement is calculated as the sum of specific requirements attached to positions in interest rate products, equities, options, commodities, foreign currencies, and credit derivatives. In each case, the capital requirement is calculated by computing a notional exposure to the underlying position and adjusting for an appropriate risk factor. The Pillar 2 calculation is also sensitive to the riskiness of activities.</p> <p>Firms can obtain permission to use internal models to determine market risk (very large firms); standards for the use of internal models are set out in BIPRU 7.9 and 7.10.</p> <p>Small and exempt firms</p> <p>For non-MiFID firms, the capital requirements may be flat for firms undertaking low risk activities. Generally this is a requirement for a capital buffer of six months expenses. However, where risks are greater and/or more complex in nature, then this is usually reflected in the capital requirements, which are more closely calibrated to the volume of risk being taken.</p> <p>Reporting and monitoring</p> <p>The capital requirements calculation for firms is done through an annual process known as ICAAP, wherein the firm calculates its capital requirement and then presents that calculation to the FSA. The FSA is required to agree to the calculation as part of the process. The ICAAP is part of the ARROW.</p> <p>Firms are required to monitor compliance with capital requirements at all times and immediately report to the FSA any failure to meet the minimum requirement. BIPRU firms are required to file monthly capital reports. Smaller firms are required to file quarterly reports. All reports must be filed within 20 days of period end.</p>
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	<p>BIPRU firms are subject to an annual audit by independent auditors. Smaller firms are not subject to this requirement.</p> <p>The FSA has broad powers to take action against a firm that has fallen below required capital. They include power under FSMA s.45, to vary a firm's permission on its own initiative (OIVOP), including cancelling permission or imposing new requirements or limitations on that permission, if the firm is in breach of any of the Threshold Conditions (which includes capital requirement, FSMA Schedule 6, paragraph 4).</p> <p>The FSA can also use the OIVOP tool to impose requirements on a firm, which it did during the financial crisis to require several international firms to hold local liquidity in their U.K. subsidiary. The FSA has also used OIVOPs to require firms with deteriorating financial conditions to prepare contingency plans for bankruptcy and to the quality of their segregation arrangements for client money and assets</p> <p>Unregulated affiliates and off-balance sheet</p> <p>Under the FSA's consolidated supervision regime, certain unregulated entities are caught within the scope of a group to which the FSA applies prudential requirements such as group capital requirements, group-wide systems and controls, and group-wide internal capital adequacy assessment (see BIPRU 8, in particular, BIPRU 8.5.1). Group risk (which includes risks from regulated and unregulated entities) is part of the list of Pillar 2 risks assessed in ICAAP framework (see GENPRU 1.2.30 (2) (1)). The consolidated capital adequacy framework takes account of the activities of unregulated entities within a group by looking at intra-group transactions/exposures, contingent liabilities, sources of funding and capital etc.</p> <p>At the solo level, a firm must meet certain criteria in order to benefit from a reduction in risk-weighted assets. At the group level, there are no provisions that would automatically include off balance sheet activities within the capital framework. Inclusion within the group capital will depend on the degree of connectivity with the group i.e., whether risk of contagion continues to exist notwithstanding the fact that the assets are off-balance sheet. For very large firms, the FSA requires the firm to include a consideration of risks emanating from the group (including reputational risk) in performing stress tests and scenario analyzes (GENPRU 1.2.90).</p>
Assessment	Broadly Implemented
Comments	<p>In general the requirements and processes in place to ensure that an adequate level of capital is maintained by investment firms and investment managers under the IOSCO Principles are in place. There is a technical gap in the requirement for external audit or other assurance process for a large number of small firms. However, these firms are generally on an expenditure based operational risk style charge (typically based on six months of operating expenses) and do not handle client moneys or assets. These firms report their financial information to the FSA at least quarterly as part of their regulatory reporting requirements.</p> <p>The FSA has developed a risk alert system that will indicate where a firm has breached its capital requirements based on these returns and all alerts are followed up and tracked. All firms that deal with client assets are subject to an annual external audit confirmation that they are complying with the relevant client assets rules. As a result of a review of firm and audit practices, the FSA is currently in the process of strengthening these audit requirements.</p> <p>There is some risk that the combination of little direct contact for small firms (given their numbers and the resources applied) and a lack of outside check, there is potential for an insolvent or inadequately capitalized firm to go unchecked for a long period of time. Firms in this category would not handle assets, have capital based on a simple expenditure test and are required to report their financials to the FSA on a quarterly basis with a system of automatic alerts for supervisors; the assessors do not consider this to be a material weakness in the current supervisory approach. However, the assessors were not able to get a sufficient level of detail on the number of and nature of these firms and given the emphasis placed on the requirement for auditor under the</p>

	methodology, we feel a grade of Broadly Implemented is warranted. We recommend the FSA consider extending its auditor requirement to all firms that are not purely advisory firms.
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Management and supervision</p> <p>Management and Supervision requirements are set out in the FSA Handbook, in chapters 4–10 of the Senior Management Arrangements, Systems and Controls sourcebook (SYSC). These requirements are known collectively as the common platform requirements.</p> <p>All firms, including intermediaries, must have robust governance arrangements, which include a clear organizational structure with well defined, transparent and consistent lines of responsibility; effective processes to identify, manage, monitor and report the risks it is or might be exposed to; and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements.</p> <p>FSA rules require the arrangements, processes and mechanisms referred to under SYSC 4.1.1R to be comprehensive and proportionate to the nature, scale and complexity of firm’s activities. A firm must take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that:</p> <ul style="list-style-type: none"> • it is clear who has which of those responsibilities; and • the business and affairs of the firm can be adequately monitored and controlled by the directors, relevant senior managers, and governing body of the firm. <p>Periodic evaluation of its internal controls and risk management processes</p> <p>Under the FSA rules firms are required to have an internal audit function to examine and evaluate the adequacy and effectiveness of the firm's systems, internal control mechanisms and arrangements. Other than in the circumstances below relating to client asset controls, there is no formal requirement for an independent party to periodically evaluate a firm’s internal controls.</p> <p>Firms are required to adequately establish, manage and monitor their outsourcing arrangements. Where the outsource provider is an intermediary firm they can, and often do, appoint an external auditor to provide an independent control assurance report (such as SAS 70) to report on their system and control environment. Depending on the nature, scale and complexity of its business, it may be appropriate for a firm to have a separate compliance function with staff sufficiently independent to perform their duties objectively.</p> <p>The output and the results of these independent compliance and internal audit control functions are available to FSA firm supervisors for relationship managed firms, and utilized in the assessment of the firm’s controls and systems as part of the ARROW risk assessment process. Where a firm elects to appoint an external auditor to carry out an evaluation of controls, the auditor’s reports to management are available to the FSA.</p> <p>For firms holding client money and/or custody assets, the FSA requires the external auditor to express an opinion annually as to whether the firm has maintained systems adequate to enable it to comply with the applicable chapters of our Client Assets Sourcebook (CASS). Furthermore, CASS requires the firm to provide the FSA with written confirmation from the firm’s auditor on the firm’s systems and controls when it is adopting a different method or an alternative approach for client money and asset reconciliations or segregation from the standard methods set out in CASS. The FSA is currently proposing measures to strengthen the robustness of these external audit confirmations following a review that identified some weakness in current practices.</p>

	<p>Under the FSMA (Communications by Auditors) Regulations 2001, auditors have a legal duty to report to the FSA certain contraventions, or possible contraventions, of rules and legislation and other matters that they reasonably believe are or may be of material significance to the FSA.</p> <p>Resolution of investor complaints</p> <p>Intermediaries must establish and maintain effective and transparent procedures for the reasonable and prompt handling of complaints. The FSA expects these procedures to be accessible to consumers at no cost. In addition when internal firm complaints procedures have been exhausted, the customer may seek assistance from the Ombudsman.</p> <p>Safeguarding client assets and actions to protect in the case of financial insolvency of the intermediary</p> <p>FSA rules require segregation of client assets and money by investment intermediaries (Principle 10; CASS). The rules, set out in the Client Asset sourcebook, are designed to facilitate the orderly wind down of firms so as to allow the speedy return of client assets.</p> <p>Since the financial crisis, the FSA has introduced additional measures designed to strengthen the client asset regime and expedite the timely return of client assets. This includes the setting up by the FSA of a specialist client assets team to support its work in this area.</p> <p>Further measures are planned which will be the subject of consultation in the first half of 2011. These include measures to improve the quality of documentation so that insolvency practitioners can gain rapid access to information that will allow them to give priority to the return of client assets following a firm's failure. The U.K. government is also planning to introduce reforms to insolvency law to provide a clearer legal basis for insolvency practitioners to prioritise the return of client assets.</p> <p>Customer information</p> <p>A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client. In addition, when making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:</p> <p>knowledge and experience in the investment field relevant to the specific type of designated investment or service;</p> <p>financial situation;</p> <p>investment objectives; and</p> <p>so as to enable the firm to make the recommendation, or take the decision, which is suitable for him.</p> <p>Know your customer requirements</p> <p>A firm is required to obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:</p> <ul style="list-style-type: none"> • meets his investment objectives; • is such that he is able financially to bear any related investment risks consistent with his investment objectives; and • is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.
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	<p>The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.</p> <p>The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.</p> <p>Customer access to terms and conditions of services</p> <p>A firm must provide a retail client with the following general information, if relevant:</p> <ul style="list-style-type: none"> • the name and address of the firm, and the contact details necessary to enable a client to communicate effectively with the firm; • in the case of MiFID or equivalent third country business, the languages in which the client may communicate with the firm, and receive documents and other information from the firm; • the methods of communication to be used between the firm and the client including, where relevant, those for the sending and reception of orders; • a statement of the fact that the firm is authorized and the name of the competent authority that has authorized it; • in the case of MiFID or equivalent third country business, the contact address of the competent authority that has authorized the firm; • if the firm is acting through an appointed representative or, where applicable, a tied agent, a statement of this fact specifying the EEA State in which that appointed representative or tied agent is registered; • the nature, frequency and timing of the reports on the performance of the service to be provided by the firm to the client in accordance with the rules on reporting to clients on the provision of services (COBS 16); • in the case of a common platform firm, a description, which may be provided in summary form, of the conflicts of interest policy; • other than in the case of a common platform firm, when a material interest or conflict of interest may or does arise, the manner in which the firm will ensure fair treatment of the client; and • in the case of a common platform firm, at any time that the client requests it, further details of the conflicts of interest policy. <p>Information needed to make a balanced and informed investment decision</p> <p>A firm must provide appropriate information, in a comprehensible form, to a client about:</p> <p>the firm and its services;</p> <p>designated investments and proposed investment strategies; including appropriate guidance on and warnings of the risks associated with investments in those designated investments or in respect of particular investment strategies;</p> <p>execution venues;</p> <p>costs and associated charges; and</p> <p>so that the client is reasonably able to understand the nature and risks of the service and of the specific type of designated investment that is being offered and, consequently, to take investment decisions on an informed basis.</p>
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	<p>Statement of account and information on remuneration</p> <p>A firm must provide a retail client with information on costs and associated charges including, if applicable:</p> <ul style="list-style-type: none"> • the total price to be paid by the client in connection with the designated investment or the designated investment business or ancillary services, including all related fees, commissions, charges and expenses, and all taxes payable via the firm or, if an exact price cannot be indicated, the basis for the calculation of the total price so that the client can verify it. The commissions charged by the firm must be itemised separately in every case; • if any part of the total price referred to (1) is to be paid in or represents an amount of foreign currency, an indication of the currency involved and the applicable currency conversion rates and costs; • notice of the possibility that other costs, including taxes, related to transactions in connection with the designated investment or the designated investment business may arise for the client that are not paid via the firm or imposed by it; and • the arrangements for payment or other performance. <p>Internal controls</p> <p>The rules requires a firm to establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives (or where applicable, tied agents) with its obligations under the regulatory system and for countering the risk that the firm might be used to further financial crime.</p> <p>SYSC 3.2.7 G states that, depending on the nature, scale and complexity of its business, it may be appropriate for a firm to have a separate compliance function. The organization and responsibilities of a compliance function should be documented. A compliance function should be staffed by an appropriate number of competent staff who is sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the firm’s relevant records as well as ultimate recourse to its governing body.</p> <p>A firm which carries on designated investment business with or for retail clients or professional clients must allocate to a director or senior manager the function of:</p> <ul style="list-style-type: none"> • having responsibility for oversight of the firm’s compliance; and • reporting to the governing body in respect of that responsibility. <p>Handling conflict of interests</p> <p>SYSC 10.1.3 R requires firms to take all reasonable steps to identify conflicts of interest between the firm, including its managers, employees and appointed representatives (or where applicable, tied agents), or any person directly or indirectly linked to them by control, and a client of the firm; or one client of the firm and another client that arise or may arise in the course of the firm providing any regulated activities or ancillary activities.</p>
Assessment	Broadly implemented
Comments	<p>The FSA’s rulebook has detailed standards in its rules relating to management and supervision, protection of customers and internal controls within an authorized firm. The FSA has also undertaken an extensive program of supervisory and policy work to support its “treating customers fairly” initiative. There is no formal requirement for an independent party to periodically review internal controls except for those firms holding client assets where an annual audit confirmation of compliance with the client assets rules is required. The FSA has standards on the obligations of the firm’s internal audit function to examine and evaluate the adequacy and effectiveness of the firm’s systems, internal control mechanisms and arrangements. The FSA uses</p>

	these internal audit reports in its own supervisory assessment. While there is a gap in the requirement for an independent person to periodically review internal controls of all authorized firm, the role of the firm's internal audit and the independent audit confirmation requirement where firms' hold customer assets goes some way to mitigate the lack of a requirement for an independent review of internal systems and controls
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>Monitoring and winding down</p> <p>The FSA monitors financial conditions of intermediaries as described above. It also requires the segregation and safekeeping of client assets, in order to minimize losses to clients in the event of a failure. The FSA can take a range of actions against a firm that is experiencing financial difficulty using its powers under FSMA s.45. The FSA could give the firm direction to cease expanding its business, stop opening accounts, sell particular assets etc. In response lessons learned in the failing of Lehman Brothers, in which client assets were not properly segregated and client losses were experienced, the FSA has taken steps to establish a specialist Unit to focus on client asset supervision. The Unit includes a 'resolution team' and it is envisaged that this team would take the lead in helping to ensure that investment firms can be wound down in a way that ensures the protection, and speedy return, of assets belonging to clients. Where that market intermediary is also a deposit-taker, it may be dealt with under the U.K.'s Special Resolution Regime detailed in the Banking Act, 2009.</p> <p>There is no specific plan or policy in place governing the wind up of a firm. Those firms that are in close and continuous supervision or 'relationship managed firms' would have ongoing oversight and supervisors would react to declining trend in capital or a breach of capital requirements using the s.45 or OIVOPs powers. Firms that are on an internal watch list for prudential reasons would be subject to intensive oversight. FSA staff was able to provide a number of examples in which firms in financial difficulties were placed under intensive supervision, subject to restrictions or wound down.</p> <p>There is no clear plan, however, for small firms that are not relationship managed. As we have noted earlier, this group is normally very small firms without client assets. However, not all small firms are very small and there is still a significant group for which there is no plan in place.</p> <p>The FSA can request the Secretary of State to apply to a court to appoint a liquidator for a firm in the event of a wind down. Once in liquidation an investment firm is subject to the general laws of bankruptcy. There is a current discussion in the U.K. regarding bringing in a special resolution regime but this is likely to apply only to banks and investment banks.</p> <p>Notification</p> <p>Where a firm has gone into default, a public declaration will be made by the Financial Services Compensation Scheme (FSCS). The FSCS maintains a list of firms that have been declared in default by either it or the FSA.</p> <p>Investor compensation</p> <p>The FSCS was established by the FSA under the FSMA to compensate consumers when authorized firms are unable, or likely to be unable, to satisfy claims against them. The FSCS covers claims from eligible persons in regard to protected: deposits; contracts of insurance; investment business; home finance mediation; and non-investment insurance mediation (although there is a separate deposit insurance and insurance compensation fund as well). The FSCS does not, however, compensate for investment loss. The FSCS can pay compensation up to a limit of £50,000.</p>

	<p>The FSCS is not a prefunded plan. When a pay-out is made to investors, member firm is subject to levies based on their activities and size. Recently the FSCS has made very large payouts to investors as a result of the failure of two large investment firms. The FSCS paid out a total of £207 million in 2009, with reported pay outs in 2010 at more than £400 million.</p> <p>Crisis management coordination</p> <p>The FSA, BoE and HMT form the Tripartite Authorities. The agreement between the Tripartite Authorities is designed to foster communication and development of common policy and to address financial disruption to the U.K. economy. This is guided by a memorandum of understanding between the authorities (http://www.fsa.gov.U.K./pubs/mou/fsa_hmt_boe.pdf). Regular meetings take place at a senior level and working –level groups are set up with issues with specific institutions and the members there would co-operate to resolve the issue.</p> <p>Improving crisis management planning is work ongoing in the United Kingdom. Global crisis management groups (CMGs) for the firms included in the FSB’s list of cross-border banks have been constituted. These groups contain the key national authorities (central banks, supervisory authorities, special resolution authorities) according to the country composition of the core global college for each bank. There is work ongoing to establish similar groups at the European level for a similar set of financial institutions. These firm specific crisis management groups build on the supervisory college arrangements for the largest firms and the central bank networks which in themselves enable communication and cooperation between national authorities at the cross-border level.</p>
Assessment	Broadly implemented
Comments	<p>The FSA has broad powers to act in the case of a failing firm and the legal framework is in place for a wind up of the firm (taking aside the ongoing discussions for resolution of the very largest investment banks). However, there is no policy and procedure in place for handling a failing firm. While the FSA gets information from financial returns that would highlight the declining financial position in small firms, there remain gaps in the monitoring of small firms for this purpose as the information is infrequent (semi-annual) and self reported and there are. We recommend that the FSA institute a policy for the handling of a failing firm so that there is a consistent and widespread understanding of how this is to be handled. The FSA should consider locating the operational responsibility for this work in a specialized unit. We further recommend and that additional safeguards be put in place (as the system relies heavily on self-reporting) with some combination of annual audit requirements for these firms or on-site examination work.</p>
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>The United Kingdom has a wide range of organized trading platforms in those asset classes that lend themselves to trading on organized markets. These include six RIEs and more than 20 investment firms authorized to operate MTFs. In the area of post-trade services, there are five RCHs, one of which, Euroclear U.K. & Ireland (EUI), provides the securities settlement system. There are also a number of ‘service companies’ providing services such as trade matching and confirmation and the provision of order routing facilities. A feature particular to investment business and financial markets is the ‘exempt’ regime provided for investment exchanges and clearinghouses.</p> <p>Recognition and authorization framework</p> <p>These infrastructure entities can apply to be recognized, under FSMA Part XVIII, as a RIE or RCH. RBs are subject primarily to recognition requirements, approved by Parliament. However, the FSA is empowered to add guidance to the recognition requirements, make notification rules and is responsible for both granting recognition on approval from HMT and for oversight of the their ongoing compliance with the recognition requirements.</p>

	<p>A person who ‘arranges’ transactions in (regulated) financial instruments, including the provision of facilities in which others may participate, or who operates a multilateral trading facility is conducting a regulated activity as defined in FSMA (Regulated Activities Order) 2001 (as amended for MiFID). Such a person may apply to be recognized as a Recognized Investment Exchange (RIE), which they will need to do if they wish to be listed as the operator of an EU ‘regulated market’, or otherwise must seek authorization as an investment firm with a ‘permission’ to operate an MTF.</p> <p>The main regulations governing RIEs and RCHs are set out in FSMA Part XVIII, the Recognition Requirements Regulations 2001 (the recognition requirements, or RRRs); and in the FSA’s Recognized Investment Exchanges and Recognized Clearinghouses Sourcebook (REC). Any other entity intending to operate a multilateral trading facility must seek a Part IV permission (FSMA, Part IV) and operate in compliance with Part 5 of the FSA’s Market Conduct Sourcebook (MAR 5).</p> <p>The FSA application process requires applicants to submit information, evidence and explanatory material, including supporting documentation, necessary to demonstrate to the FSA that the recognition requirements will be met. Detailed guidance on the materials required to be submitted in an application is provided by the FSA.</p> <p>An applicant must demonstrate that the persons who effectively direct the business and its operations are of sufficiently good repute and sufficiently experienced to ensure the sound and prudent management and operation of the financial markets operated by it; and that that the systems and controls used in the performance of its relevant functions are adequate and appropriate for the scale and nature of its business.</p> <p>An investment firm intending to operate an MTF must be an authorized firm with specific permission to operate a MTF. In addition to satisfying the FSA that it meets the basic requirements common to all firms seeking authorization, the firm must satisfy the FSA of its competence to operate a MTF. In this context, the firm must satisfy the FSA that in operating an MTF it will meet the requirements for operating an MTF set out in the FSA Handbook (MAR 5). In the case of both RIE and MTF applicants, FSA due diligence on a firm’s competence to operate a trading platform includes a technical assessment of the firm’s trading systems (either conducted onsite or by requested an assessment report). The application process is an in-depth one with a series of meetings with senior management and the board and an extensive review both on and offsite. The markets team involves technical specialists (for example, IT specialists) from elsewhere in the FSA.</p> <p>The FSA, as the competent authority responsible for the oversight of exchanges and other trading platforms, must satisfy itself that RIEs and MTFs meet the specific requirements placed on them in respect of monitoring, surveillance and supervision of the trading system. This requires the FSA to assess, in particular, the adequacy of the operator’s systems and controls, including its compliance arrangements and its market monitoring capabilities.</p> <p>A RIE must have financial resources sufficient for the proper performance of its relevant functions including taking into account whether it acts as a central counterparty or otherwise guarantees the performance of transactions in specified investments, to the counterparty and market risks to which it is exposed. All authorized firms are required to have resources that the FSA considers adequate in relation to the activities they carry on as set out in the Threshold Conditions (set out in Schedule 6 FSMA and the COND sourcebook in the FSA Handbook). An authorized firm operating an MTF that assumes settlement risk would be subject to appropriate financial resource requirements in respect of that risk.</p> <p>An operator must remain in compliance with the recognition requirements at all times. The FSA has power to provide guidance to adjust to changing market circumstances. The Recognition</p>
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	<p>requirements include that an RIE to have:</p> <p>appropriate measures to reduce the extent to which the facilities can be used for a purpose connected with market or financial crime and to facilitate their detection and monitor their incidence (RRR Para 4(2)(f); REC 2.10.1);</p> <p>transparent and nondiscriminatory rules, based on objective criteria, governing access to, or membership of, its facilities; (RRR, Para 7B, REC 2.7.1); and systems and controls for the performance of its relevant functions that are appropriate for the scale (RRR Para 3, REC 2.5.1).</p> <p>Similarly, the rules in relation to MTF operators also apply on an ongoing basis. All authorized firms must have the capacity to carry out their regulatory obligations and seek to prevent market abuse RIEs and MTFs do not have responsibility for the general regulation of their members. That falls directly to the FSA where members are FSA-regulated. The FSA must satisfy itself that RIEs and MTFs meet the requirements placed on them in respect of:</p> <ul style="list-style-type: none"> • dispute resolution and appeals procedures its technical systems standards and procedures related to operational failure; • its record keeping systems; • reports of suspected breaches of law; • arrangements for holding client funds and securities; and • information on how trades are cleared and settled. <p>The FSA must satisfy itself that RIEs and MTFs meet the requirements placed on them in respect of ensuring that business conducted by means of their facilities is conducted in an orderly manner and afford proper protection to investors. Similarly, it must satisfy itself as to the effectiveness of arrangements an RIE makes through trading rules and its monitoring of trading, to prevent market abuse and financial crime, and as to the appropriateness of its systems and controls in relation to the receiving and matching of orders.</p> <p>The FSA expects that a trading platform would utilize appropriate mechanisms, including volatility halts where appropriate, to maintain an orderly market. The suspension of trading in a listed security normally flows from a suspension of listing ordered by the U.K. LA. This may happen at the request of a company ahead of a significant announcement or as the result of some breach of listing rules by an issuer (e.g., failure to publish accounts).</p> <p>Trading rules</p> <p>The recognition requirements require an exchange to operate what traditionally in the U.K. has been referred to as a “proper market.” In practice, this means that where a RIE operates a ‘regulated market’ standards for the admission of financial instruments to trading will be set out in the recognition requirements. These are based on MiFID Article 40 and the MiFID Regulation—in respect of transferable securities (Article 35), units in collective investment undertakings (Article 36) and, derivatives (Article 37). The core requirement in MiFID is that a regulated market’s admission rules must ensure that all financial instruments admitted to trading are capable of being traded in a fair, orderly and efficient manner.</p> <p>Where an operator admits instruments to trading on an MTF, and those instruments are not admitted to a regulated market, the FSA will have regard to whether the admission rules are designed to promote fair and orderly trading. For instance, by ensuring a sufficient range of holders to bring about adequate forces of supply and demand, any limitations on who may hold the instrument, and whether the operator has adequate procedures for obtaining information relevant to determining whether or not to suspend or discontinue trading in the instrument.</p>
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	<p>Securities and market participants</p> <p>A RIE is required to notify the FSA of its intention to introduce new rules or to introduce (or remove) products from trading. While the FSA is not required to approve formally the specific rules of an individual RIE for the admission of a financial instrument. ; in practice, RIEs consult the FSA (as part of the close and continuous supervisory relationship) on the rules they are proposing in relation to planned product launches (other than a security or option—meaning generally futures) to ensure that they meet the requirements relating to the recognition requirements for admission of financial instruments to trading. In relation to derivatives these include: requirements that the terms of contracts need to be clear, price and value of the underlying must be reliable and publicly available, sufficient information is available to inform an investment decision, and that robust procedure to determine the settlement price, where settlement may involve physical delivery appropriate arrangements are in place. Rules relating to default procedures are required to be formally approved by the FSA as these relate to the protections of netting in Companies legislation.</p> <p>The assessors confirmed with RIEs that In practice, they do notify rules and product details to the FSA and these are actively reviewed by the FSA against the relevant criteria for new derivative products and compliance with relevant recognition requirements and subject to communication of a non-objection by the FSA when the review is completed.</p> <p>RIEs are required to make transparent and nondiscriminatory rules, based on objective criteria, governing access to, or membership of, their facilities. MTFs are required to have access rules based on objective criteria. Both these requirements are based on and implement MiFID.</p> <p>Fairness of order execution procedures</p> <p>The order handling and order routing procedures of investment firms must be disclosed to clients and treat clients fairly (FSA Handbook, COBS 11). U.K. RIEs and MTFs do not themselves operate order-routing processes. Under U.K. regulation, order routing is regarded as an arranging activity that requires a specific permission and which is subject to the relevant rules. Where an authorized firm that routes orders, controls or has a significant commercial interest in a RIE or a MTF, the FSA pays particular attention to its management of potential conflicts of interest. RIE and MTF rules governing trading must be transparent</p> <p>When the FSA reviews a proposed trading methodology or algorithm, an important consideration is its fairness. In determining whether an RIE is ensuring an orderly market and the proper protection of investors, the FSA considers whether the exchange’s arrangements and practices enable members and clients for whom they act to obtain the best price available at the time for their size and type of trade</p> <p>Operational information</p> <p>RIEs and MTFs are required to have transparent rules relating to transactions on the market. Those rules must also provide for fair as well as orderly trading. MiFID, harmonized across all EEA trading, establishes the transparency requirements in respect of shares admitted to trading on regulated markets in the EEA. For trading in other instruments, there are currently no specific EU provisions (although that is likely to change following the European Commission’s current review of MiFID).</p> <p>However, in considering whether an RIE is complying with the requirement to ensure that business conducted by means of its facilities is conducted in an orderly manner and so as to afford proper protection of investors, the FSA evaluates whether the RIE’s arrangements and practices (for instruments other than shares admitted to trading on EEA regulated markets) ensure sufficient pre-trade and sufficient post-trade transparency (Transparency is addressed in more detail in relation to Principle 27 below).</p>
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	<p>RIEs must have effective arrangements, including the monitoring of transactions, for monitoring and enforcing compliance with their rules. This is reinforced by the requirement to have systems and controls that are adequate, and appropriate to the scale and nature of the business, for monitoring of transactions on the RIE. Additionally, where the RIE provides electronic access, the FSA considers the quality and completeness of the audit trail of any transaction processed through an electronic connection system.</p> <p>More generally, RIEs are required to have satisfactory arrangements for the recording of transactions. In determining whether those arrangements are satisfactory, the FSA may have regard to whether the U.K. recognized body has arrangements for creating, maintaining and safeguarding an audit trail of transactions for at least three years (five years in respect of transactions carried out by members who are not incorporated in the U.K. if the transactions were executed on a ‘regulated market’ operated by the RIE). In addition, an RIE must ensure that appropriate measures, including the monitoring of transactions effected on the U.K. RIE, are adopted to reduce the extent to which the U.K. RIE’s facilities can be used for a purpose connected with market abuse or financial crime and to facilitate their detection and monitor their incidence.</p> <p>The recognition requirements require the FSA to have regard to the extent to which to information relating to the effecting of transactions is transmitted promptly and accurately (performance, capacity and reliability of an RIE’s information technology systems); confidential information is used only for proper purposes; and systems are protected from damage, tampering, misuse or unauthorized access.</p> <p>Where relevant, RBs must also comply with FSMA s.348 (restrictions on disclosure of confidential information by the FSA).</p> <p>Similar requirements apply to authorized firms operating MTFs, through a combination of the rules which have general application to authorized firms and the specific provisions set out in MAR. In 2010 the FSA articulated that it will regulate the larger MTFs in accordance with the same standards as RIEs.</p>
Assessment	Fully implemented
Comments	<p>The U.K. regime has a requirement for a person operating a trading system to be either recognized or authorized before they are able to operate. The regime has extensive requirements for recognition of exchanges and clearinghouses. These are set out in detail in the Recognition Requirements and the FSA’s rulebook. Any other entity intending to operate a multilateral trading facility must seek a Part IV permission (FSMA, Part IV) as an authorized firm and operate in compliance with Part 5 of the FSA’s Market Conduct Sourcebook. The FSA provides extensive guidance on the requirements under each key recognition criteria that cover the elements set out in the IOSCO principles and methodology, including notification of rule and product changes. While there is no formal requirement for approval of rules or products other than in limited circumstances, in practice, the combination of notification requirement, need for the FSA to be satisfied that an RIE has assessed new rules and products against the relevant detailed recognition requirements means material rule changes and proposed new products are reviewed by the FSA as part of the FSA’s supervision by its markets team. The FSA reviews rules and products against the criteria for a “proper market” and to ensure they are consistent with the business model of the trading system and its threshold recognition or authorization permissions. The market operators confirmed that a review is undertaken in practice, and once the FSA is satisfied as a matter of procedure the FSA confirms that they have no objection to the rules or product proposal.</p>

	<p>In the case of the recognition of an RIE, the FSA will make a recommendation to HMT which will review the FSA report review along with a report from the OFT. HMT will make a decision and the recognition order is made by the FSA. In the case of investment firms that operate MTFs, the authorization decisions are made by the FSA. The assessors did not consider the role of HMT in the recognition process caused any issue in terms of current compliance with the Principles.</p> <p>However, given the increasing convergence and blurring of lines between various categories of trading system and FSA's policy that it will treat RIE and MTF's consistently from a supervisory point of view, the assessors considered there might be some benefit in making the regulator solely responsible for both recognition of RIEs and authorization of MTFs going forward. However,</p> <p>In addition, There will also need to be clarity on the responsibilities for authorizing and supervising MTF's under the proposed FCA and PRA structure since some authorized firms operating MTFs may be PRA regulated entities. The assessors consider that there should clarity on responsibilities for authorization and supervision of MTFs and that they be subject to similar standards of review and supervision by a single regulator to the maximum extent practicable in the proposed new regulatory structure.</p>
Principle 26.	<p>There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>
Description	<p>Regulatory oversight program and verifying continuing compliance</p> <p>The FSA has responsibilities and powers for the supervision of exchanges and trading systems under the Recognized Investment Exchange framework. The FSA performs similar functions for Multilateral Trading Firms (MTFs) that operate under the authorized firm regime in the United Kingdom. These categories of trading platforms are described in Principle 25 above.</p> <p>Under the recognition conditions, trading platforms are required to monitor activity on their markets to ensure orderly trading and prevent market abuse. Platform operators need to have rules governing member/participant behaviour for trading on their platforms and may need to investigate any departures from those rules that they detect or observe. However, RIEs do not have responsibility for the general regulation of their members. The FSA does so where a member is an FSA authorized firm or in the case of non-U.K. firms the firm's home regulator does this.</p> <p>The FSA is responsible for ensuring that RIEs remain in compliance with their recognition requirements. RIEs are required to notify the FSA, usually immediately, of significant events in relation to trading (e.g., suspension of facilities, inability to operate), decisions to place a member into default and the taking of any disciplinary action against a member, and by undertaking thematic reviews by the FSA across sectors. Currently, all RIEs are subject to an annual ARROW style assessment and as significant infrastructure providers are subject to 'close and continuous supervision.' This includes regular interaction by FSA staff with the Board and senior management of the RIE or MTF with more in depth on site reviews of specific issues, including IT systems reviews and assessments of surveillance systems, depending on the type of risks identified during the annual ARROW assessment review.</p> <p>Real-time monitoring and access to trade information and transaction reporting</p> <p>The FSA relies on trading platforms to take the main responsibility for real-time monitoring of market activity but the FSA has real-time access to pre- and post-trade information via commercial suppliers. The FSA also receives end-of-day transaction reports of all securities, and many classes of derivative, transactions involving U.K. firms. It also receives transaction reports from other EEA regulators of transactions involving branches of U.K. firms in their jurisdictions (and supplies transaction reports to other EEA regulators on a similar basis).</p>

	<p>Changes to rules</p> <p>RIEs are subject to extensive requirements to notify the FSA. Where notice of a regulatory provision is submitted, the FSA has 30 days in which to call the issue in for further review. In practice, RIEs normally consult informally with the FSA at an early stage when considering any significant rule change. Public consultation on rule changes is initiated by the RIE itself.</p> <p>RIEs are required under the recognition requirements to have appropriate procedures for making rules keeping them under review and amending them including public consultation. The FSA must formally approve any changes to an RIE’s default rules. Other rules and proposals relating to new products must be notified to the FSA. The rule process and product review process is discussed above in Principle 25.</p> <p>Failure of an RIE to comply with conditions of approval</p> <p>The FSA has several means of addressing situations where a trading platform is unable to comply with the conditions of its approval. While it will seek to resolve issues initially through supervisory discussion, the FSA has formal power to take action against trading platforms. In the case of RIEs, the FSA has a ‘power of direction’ (FSMA s.296, REC 4.6) that it can use to require the exchange to become compliant with its recognition conditions or other provisions of FSMA as appropriate.</p> <p>The FSA is also empowered to revoke recognition if it appears that a recognized body is failing, or has failed to satisfy the recognition requirements or is failing, or has failed, to comply with any other obligation imposed on it under the FSMA. In its guidance on the power to revoke, the FSA notes that it would consider revoking recognition if it considered that it would not be possible for the recognized body to comply with a notice issued using the power of direction (FSMA s.297, REC 4.7).</p> <p>The FSA is empowered to take a broadly similar approach with an authorized firm operating an MTF. In the case of authorized firms, the FSA is also empowered to impose financial penalties for breaches of FSA rules.</p>
Assessment	Fully implemented
Comments	The FSA conducts a structured program of risk-based supervision of RIEs and MTFs designed to ensure compliance with relevant recognition or authorization requirements, including the integrity of trading and prevention of market abuse. The FSA has adequate powers to issue directions or to revoke recognition where the RIE is not meeting its recognition requirements or where it fails to comply with an obligation under the FSMA, including failure to comply with a direction from the FSA.
Principle 27. Regulation should promote transparency of trading.	
Description	<p>The regulatory framework provides for pre and post-trade transparency of the trading of all equities admitted to trading on an EEA regulated market. These requirements are established under MiFID and apply across the EEA.</p> <p>Pre-trade transparency</p> <p>Order-driven systems must make public (at least) total orders at each of the five most competitive price levels on each side of the order-book. Quote-driven systems must make public the best bid and offer prices, together with volumes at those prices, of each market maker. Periodic auction trading systems must make public the price at which the system would best satisfy its trading algorithm and the volume that would be potentially executable at that price. Other systems, either hybrids of the above or where price determination is of a different nature, must make public adequate information as to the level of orders or quotes and of trading interest.</p>

	<p>Specific waivers from pre-trade transparency are available for:</p> <ul style="list-style-type: none"> • Orders that are large in scale as determined by MiFID; • Negotiated Trades (i.e., off book trades involving one or more members of the system) provided that the trade is executed within the current volume-weighted spread of the system if it is a continuous trading system, or by reference to a suitable reference price generated by the system if it is not a continuous system; • Reference Price Systems, where the system executes trades at a price (or prices) generated by another system and the price is considered reliable and is widely published; and • Orders held in Order Management Systems pending disclosure to the market (e.g., iceberg orders). <p>In relation to the trading of liquid shares, systematic internalizers are required to maintain continuous quotes and to deal at those prices if they trade up to specified sizes (subject to exemptions for volume weighted average price trades and portfolio trades). They may offer price improvement for professional investors but not for retail investors.</p> <p>Post- transparency</p> <p>In relation to any instrument admitted to trading on an EEA regulated market, all trades, whether executed on a regulated market, an MTF or OTC, must be published. This should take place as close to real-time as possible, but competent authorities may allow specified publication delays for risk trades above specified sizes.</p> <p>Information to participants and public</p> <p>Pre- and post-trade information must be made public. Arrangements to make information public must, amongst other things, facilitate the consolidation of data and make the information available to the public on a nondiscriminatory commercial basis at a reasonable cost.</p> <p>MiFID permits the competent authority in each member state to grant permission for delayed publication of large risk trades in equities in line with the conditions and parameters set out in the MiFID Regulation. If the competent authority exercises its right to grant derogation, it must do so for all trading venues (including OTC). The U.K. has exercised its power to grant derogation as a general derogation. The conditions governing delayed publication restrict the availability of delay to transactions:</p> <p>between a MiFID investment firm dealing on own account and a client of that firm;</p> <p>where the transaction is equal to or exceeds the relevant minimum qualifying size, as specified in Table 4 in Annex II of the MiFID Regulation</p> <p>MiFID requires that derogation, if granted, must be made available to all parties for trades that meet the conditions. MiFID provides no scope to a member state to prescribe alternative arrangements. The present arrangements are being reviewed as part of the European Commission's current review of MiFID.</p> <p>For instruments other than shares admitted to trading on EEA regulated markets, the FSA may have regard to a RIE's pre- and post- trade transparency arrangements in considering its ongoing compliance with its obligation to maintain the orderly conduct of business and proper protection of investors. The FSA expects MTFs providing trading in an instrument admitted to a regulated market to have equivalent transparency standards for that instrument.</p>
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Assessment	Broadly implemented
Comments	<p>The regime provides a detail pre- and post-trade transparency framework with clearly defined specific exceptions. Trade information must be made public on a nondiscriminatory basis to all participants. The U.K. applies that MiFID regime without any specific derogations or additional waivers that could be regarded as lowering the standard of pre and post trade transparency below that set by MiFID or inconsistent with the nature of the U.K.'s general commitment to transparency for equity market trading.</p> <p>Given the multiple venues in the U.K. and fragmentation of trading across Europe there are challenges in ensuring consolidation of post trade data and information relevant to all lit and dark trading venues, however, categorized. There are current debates as to the extent of dark liquidity and internalization of trading in a European context. These are issues relevant across Europe being considered as part of the current MiFID.</p> <p>The FSA has stated that current standards of post trading transparency could be improved in terms of quality, timeliness, and consolidation of post trade reporting across trading venues in the U.K. and Europe. They consider standards of trade transparency have been affected by the dispersion of trading across multiple venues and the lack of a consolidated reporting mechanism. The ability to report trades through different venues has, according to the FSA, resulted in greater permissible (on average) delays compared to pre-MiFID. There are also concerns that in the current environment the 3-minute post trade reporting delay has become the norm rather than the exception, the large in size exception needs review and there should be a be clear mechanism for post trade consolidated reporting. There are also issues relating to post trade reporting for non - equity transactions and enhanced disclosure relating to short selling.</p> <p>The assessors note these challenges arising from the dynamic changes in current market structures driven by a number of key factors, including rapid developments in technology and dispersion of trading among a range of trading venues as a result of competition post MiFID. These are challenges across Europe and are under active consideration as part of the current MiFID review. The assessors consider the U.K. regime does not derogate from the core MiFID pre and post transparency regime in any way inconsistent with its general commitment to market transparency. Furthermore, since the MiFID equity transparency regime is implemented by means of a Regulation (i.e., which is directly applicable as a legal instrument), the U.K. does not have flexibility to apply a different regime.</p> <p>Nevertheless, given the concerns identified as part of the current MiFID review on specific elements in the current regime given increased competition and fragmentation of trading across multiple trading venues, and in particular the absence of a regime for effective consolidation in Europe of post- trade information, the assessors considered the current state of transparency to be less than fully compliant with the IOSCO Principles and the principle to be broadly implemented.</p>
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>Misconduct in relation to a financial market is defined as a 'financial crime' under the FSMA. FSMA defines financial crime as including any offence involving:</p> <p>fraud or dishonesty; misconduct in, or abuse of information relating to, a financial market; or handling the proceeds of crime (FSMA s.6 (3)).</p> <p>Part VIII of the FSMA defines in more detail the behaviors that constitute market abuse, including insider trading, market manipulation, misleading information, improper disclosure, misleading behavior (distortion) and dealing on the basis of 'relevant' inside information. FSMA requires the FSA to issue a code that gives appropriate guidance to those determining whether or not behavior amounts to market abuse (set out in MAR 1), and empowers the FSA, within the conditions and procedures set out in FSMA, to impose a penalty of such amount as it considers appropriate</p>

	<p>(FSMA Part VIII). This transposes but goes beyond the EU Directive. The FSA has also extended coverage of the civil market abuse regime to securities admitted to trading on markets such as the LSE's Alternative Investments Market (AIM) and PLUS markets, even though as MTFs, they are not required to be covered under the Directive, since they are not regulated markets.</p> <p>The FSA has issued a code of Market Abuse and has recently updated in 2010 its policy on penalties. It is expected that this revision will lead to an increase in penalties for market abuse breaches.</p> <p>Detecting and deterring market abuse</p> <p>For real-time monitoring of markets, the FSA relies substantially on the monitoring conducted by the trading platforms. RIEs and MTFs are required to monitor their markets as a condition of recognition. RIEs are under an obligation to be able and willing to co-operate, by the sharing of information or otherwise, with the FSA and investment firms are obliged to report suspicious transactions. As a matter of practice the FSA reviews on authorization and on a periodic ongoing basis the effectiveness of market operator surveillance systems.</p> <p>Transaction reporting to the regulator</p> <p>Market participants executing transactions in any financial instrument admitted to trading on a regulated market or prescribed market or any OTC derivative, the value of which is derived from or is otherwise dependent on an equity or debt related financial instrument admitted to trading on a regulated or prescribed market must report the transaction to the FSA via an Approved Reporting Mechanism (ARM). The FSA has recently begun a major upgrade to its transaction reporting systems. The new system will enhance the FSA's capacity to analyze trading across different trading venues and asset classes. This will assist investigation of suspicious trading and also in more general analysis for monitoring market developments.</p> <p>Sanctions for market abuse</p> <p>The FSA can use civil powers to impose a sanction for market abuse or by commencing criminal proceedings for breaches of the criminal law, for example, insider dealing. Criminal proceedings can result in a custodial sentence. In 2009/10, three individuals were sentenced to prison terms of between 12 and 24 months for insider dealing.</p> <p>Where the FSA uses its civil powers, it can impose a range of sanctions for market misconduct, including prohibiting or suspending an individual from undertaking specific regulated activities, censuring the individual through a public statement, or imposing a financial penalty. The FSA can also impose administrative sanctions on authorized firms and approved individuals for failing to comply with FSA requirements, in particular its high level principles.</p> <p>The FSA introduced in 2010 a new policy for determining the level of its financial penalties, which it expects will significantly increase the penalties it imposes on larger firms and high-earning individuals. Where an individual has committed serious market abuse, which the FSA expects will usually include deliberate market abuse, the starting point in calculating the penalty figure will be a minimum of £100,000.</p>
Assessment	Fully implemented
Comments	<p>The U.K. regulatory regime has clear prohibitions for conduct that constitute market abuse and the authorities supervisory efforts have a clear focus on ensuring there are real time surveillance systems, suspicious transaction reporting requirements and other mechanisms for monitoring trading and detecting breaches. The FSA has the information collection and other powers required to effectively investigate and take appropriate action including appropriate information sharing arrangements. There are clear processes in place for the referral of suspicious trading reports and other surveillance information from trading platforms to FSA enforcement.</p>

	<p>The FSA has in recent times increased its focus on criminal prosecutions for insider trading. Currently there is a gap in the ability of a real time surveillance system to capture and review order data across multiple trading venues. The transaction reporting system of the FSA captures end of day transactions for all authorized firms and can be used as forensic tool to help identify possible cross market abuse. However, it is not a real time order surveillance system. The FSA is in the process of upgrading its current transaction reporting system capabilities to enable it to keep up with developments in the market including, to the extent it identifies this is an actual problem, cross market developments. It is also reviewing evidence on whether there is evidence that cross-market abuse is a significant problem in the U.K. market and, if so, what further capabilities might be required. While not affecting the current assessment against this Principle, and while there may not yet be clear evidence in the United Kingdom that cross- market abuse is a significant problem, this is an area the FSA will need to address going forward.</p>
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>Market participants are required to report positions held in futures above certain thresholds to the RIE. Parameters for reporting are determined by an RIE, which determines at what level a position poses a threat to orderly market functioning. RIEs and MTFs report all positions to the FSA and identify, in a weekly report, the top five positions in each of a variety of future contracts.</p> <p>RIEs can require that their members supply information on client identities. The London Metal Exchange, pursuant to its rules, takes information about beneficial ownership of all positions on its markets from its members on a daily basis. ICE Futures Europe also takes this information for certain of its contracts. RIEs have the power to take action against members for failing to provide such information. The RIE's designated clearing house may exercise the appropriate power in conjunction with the RIE. Both RIEs and RCHs appear to have adequate and transparent default procedures in place.</p> <p>RIEs have the ability to compel their members to reduce positions. Again, where margin changes are required, the RIE will act in collaboration with the clearing house. Comparable provisions apply to MTFs under FSA's MAR5 sourcebook.</p> <p>Banks, Building Societies and Investment firms are subject to enforceable rules in respect of Large Exposures. These rules are set out in the Prudential Source Book (BIPRU) Section 10.5. In addition to the rules themselves, BIRPU Section 10.5 also provides a definition for what constitutes a large exposure as well as a worked example of how these should be applied. The FSA defines a large exposure as the "total exposure to a counterparty, connected counterparties or a group of connected clients, whether in the firm's nontrading book or trading book or both, which in aggregate equals or exceeds 10 percent of the firm's capital resources." Large exposures are explicitly considered under Pillar 2 of the CRD capital requirements.</p>
Assessment	Fully implemented
Comments	On the prudential side, the FSA monitors large exposures through capital requirements. In futures markets, large positions are monitored by the RIEs and RCHs; all positions are reported to the FSA along with a weekly report of large positions in specific contracts. All of this taken together will give the FSA a good picture of large exposure build ups.
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	Assessed as part of assessment of CPSS-IOSCO standards.
Assessment	
Comments	

APPENDIX I. NEW IOSCO PRINCIPLES

40. **In June 2010, IOSCO reviewed its Principles; 9 new Principles were added and one Principle removed (Principle 6).** IOSCO is currently developing a revised Methodology, which will put in place criteria for the assessment of these new Principles. Until the methodology is in place the new Principles are not assessed. However, a short discussion on the new Principles was held on the ‘state of readiness’ to implement these Principles when they come into effect. A summary of each is below.

Systemic risk monitoring and perimeter of regulation

New Principle 6: The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.

New Principle 7: The Regulator should have or contribute to a process to review the perimeter of regulation, appropriate to regularly.

41. **Due to its large remit and responsibility for the whole of financial services and its orientation toward the use of risk models in supervision, the FSA already has in place a well-developed process for analysis of systemic risk.** The FSA’s Macro-prudential Department (part of the Financial Stability Division) is responsible for stability analysis. The department works with the Markets Division to analyze stability issues arising out of the securities markets. Staff tracks developments in the securities markets via a chart pack that tracks movements in key national and global asset prices and engages with market participants through regular meetings to understand developments and trends in products and financial markets. The Financial Stability Division supports prudential regulatory functions by analysing major new transactions from a financial stability and capital markets perspective. Input is sought from Markets Division staff, who supervises bodies’ exchanges and clearinghouses and product supervisors with a view to staying abreast of key developments including new products. The FSA works closely with the BoE’s market surveillance teams to stay abreast of developments and discuss areas that need more in depth understanding.

42. **The Macro-prudential Department at the FSA has a dedicated project on identifying risks outside the regulatory perimeter, including the transfer of risks from within the regulatory perimeter such as banks to institutions outside such as hedge funds.** The FSA conducts bi-annual Hedge Fund Surveys of U.K.-based Hedge Funds and Prime Brokerage Surveys of U.K. based banks engaged in such activity. The BoE also has a group dedicated to mapping the unregulated financial sector, and the Macro-prudential Department works closely with them.

43. **The FSA has a Risk Committee, consisting of senior staff across the FSA (banking, insurance, markets, and financial stability) that meets to review risk analysis**

every two months. This information feeds into the FSA's risk modelling work as well as financial stability analysis.

44. The FSA is one-third of the Tripartite (BoE, HMT, and FSA), a formal coordinating mechanism responsible for handling crisis prevention and crisis management.

45. The United Kingdom is transitioning to a new regulatory model. The new PRA and the new FCA will both belong to the new Financial Policy Committee (FPC), responsible for overall monitoring of systemic risk and responsible for crisis prevention and crisis management. The functions of the Financial Stability division will be split between BoE, PRA and FCA and the stability and emerging risk analysis function within the Markets Division will be housed in the FCA. The FPC's function has not yet been fully defined but it appears that the FPC will have the power to direct the CPMA to take action, should the need arise (although the parameters of this are undefined).

Securitization

New Principle 8: The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.

46. Criteria for this Principle have yet to be developed; it is believe, however, that they will relate largely to conflicts of interest arising in securitization. Securitization was therefore the focus of discussion with the FSA. Securitization is used extensively in the United Kingdom. The range of assets used is varied and includes autos, trade receivables, retail and commercial mortgages and corporate loans. Banks use securitization for client financing (multi seller conduits), credit risk transfer and funding.

47. The regulation of securitization will be done on an EU-wide basis. The EU has taken the view that conflicts of interest should be addressed via obligations for investors (rather than issuers/originators). It will include conflicts of interest provisions in CRD (banks), Solvency II (insurers), AIFM (fund managers) and through central bank initiatives. As these are the major investor groups, the rules developed will *ipso facto* apply to all securitizations in the EU.

48. As of January 1, 2011, the U.K. has implemented CRD2, which addresses conflicts of interest that arise with securitization. Article 122a of CRD2 introduces new requirements for EU credit institutions who invest in securitizations. Key provisions of Article 122a that are relevant to mitigating conflicts of interest in securitization are as follows:

- An EU credit institution may only be exposed to the credit risk of a securitization position if the originator, sponsor or original lender of the securitization has explicitly

disclosed that it will maintain a net economic interest in the securitization on an ongoing basis of not less than 5 percent

- EU credit institutions should undertake appropriate due diligence before, and as appropriate after, investing in securitization positions. Stress testing should be performed regularly on positions held.
- In order to facilitate investors' compliance with their due diligence obligations, sponsor and originator credit institutions must disclose their level of retention and all materially relevant data on the credit quality and performance of individual underlying exposures, cash flows and collateral supporting a securitization exposure; they must also disclose information necessary to perform comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures
- Sponsor and originator credit institutions shall apply the same sound and well defined criteria for credit granting to both exposures to be securitized and those to be held on their book.

49. **These provisions apply to new securitizations issued on or after January 1, 2011 and, after December 31, 2014, to existing securitizations where new underlying exposures are added or substituted after that date.**

Auditor oversight

New Principle 19: Auditors should be subject to adequate levels of oversight

Principle 20: Auditors should be independent of the issuing entity that they audit.

Principle 21: Audit standards should be of a high and internationally acceptable quality

50. **The new Principles expand on Principle 16, accounting and auditing standards, and encapsulate some of the in-depth work IOSCO has done on oversight of auditors and auditor independence.** The assessment found full compliance with Principle 16, with all of the elements of the new Principles in place.

51. **In the U.K., the Financial Reporting Council ('FRC') is responsible for setting, monitoring and enforcing both accounting and auditing standards.** The FRC is an independent regulator and is not part of the FSA. The FRC has a range of statutory powers under U.K. Company Law and is funded by levies applied to various public interest entities, including publicly traded companies, large private entities and public sector organizations. The FRC is responsible for oversight over the auditing profession and the development and application of auditing standards. The overall strategy and operation of the FRC is monitored by its Board, with six operating bodies within the organization responsible for the detailed

work undertaken by the FRC. The work of some of these operating bodies is described below.

52. Monitoring of the auditing profession is performed by the FRC's Professional Oversight Board ('POB'). In particular, POB provides:

- independent oversight of the regulation of the auditing profession by the recognized supervisory and qualifying bodies;
- monitoring of the quality of the auditing function in relation to economically significant entities;
- independent oversight of the regulation of the accountancy profession by the professional accountancy bodies; and
- independent oversight of the regulation of the actuarial profession by the professional actuarial bodies and promoting high quality actuarial work.

53. The Auditing Practices Board ('APB') is responsible for setting high quality auditing standards and guidance:

- for the performance of external audit and other activities undertaken by accountants that result in reports or other output that is published, required by law or otherwise relied upon in the operation of the financial markets (i.e., assurance services); and
- in relation to the independence, objectivity and integrity of external auditors and the providers of assurance services.

54. The APB:

- issues ISAs (U.K. and Ireland)—essentially ISAs (international auditing standards) with additional local legal requirements, for example the duty to report to the regulator [<http://www.frc.org.U.K./apb/publications/isa.cfm>]; and
- issues standards on independence [<http://www.frc.org.U.K./apb/publications/ethical.cfm>].

55. The FRC also includes two operating bodies that have investigative and disciplinary responsibilities, providing a mechanism for enforcing compliance with required standards – the Financial Reporting Review Panel ('FRRP') and the Accountancy & Actuarial Discipline Board ('AADB').

56. The FRRP seeks to ensure that the annual accounts of public companies and large private companies comply with the requirements of the Companies Act 2006 and applicable accounting standards. The FRRP can ask firms to correct matters in error or, if

necessary, may require alternative remedial action (either voluntarily or through a court order). The FRRP:

- carries out its responsibilities on behalf of the Secretary of State;
- maintains a panel body that is representative of the financial reporting community;
- develops and operates a program of review of annual accounts based on risk assessment;
- enquires into accounts falling within its remit which come to its attention (i.e., those selected for review or through complaints);
- ensures that any published findings of the panel are brought to the attention of other authorities so that they can decide whether disciplinary or other sanctions should be applied;
- liaises with other authorities to foster the consistent application of accounting requirements and to improve the compliance of financial information with reporting requirements;
- contributes to and seeks to sustain an approach to enforcement that is vigorous, consistent and cost-effective; and
- seeks appropriate recognition within the financial reporting community so as to maximize the panel's deterrent effect.

57. **The Accountancy & Actuarial Discipline Board (“AADB”) is the independent, investigative and disciplinary body for accountants and actuaries in the U.K.** and, as such, deals with cases that appear to raise important issues affecting the public interest in the U.K. and that need to be investigated to determine whether or not there has been any misconduct by an accountants or actuaries.

58. **The AADB operates and administers an independent disciplinary scheme covering members of the various accountants' professional bodies (ACCA, CIMA, CIPFA, ICAEW and ICAS).** The AADB also operates a separate disciplinary scheme covering members of the Institute and Faculty of Actuaries.

Credit rating agencies

New Principle 22: Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision

59. **As of July 1, 2011 the European Securities and Markets Authority (ESMA) will be responsible for direct supervision of all CRAs issuing credit ratings in Europe.** A future assessment would have to determine whether ESMA, rather than the FSA or CPMA, is adequately fulfilling this function.

60. **CRAs are required to adhere to the Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies since 7 September 2010.**

61. **Credit rating agencies are required to disclose their Code of Conduct.** While CRAs are not obliged to adhere to the IOSCO Code of Conduct, the EU CRA Regulation covers the IOSCO Principles set out below as well as additional requirements. The EU CRA Regulation goes indeed beyond the IOSCO Principles.

Independence and avoidance of conflicts of interest

62. **The Regulation requires sound internal controls and sound reporting lines, clearly separating the rating function from business incentives.** In addition, independent, nonexecutive members of the administrative or supervisory Board of the credit rating agency need to ensure effective control (Article 6 and Annex I, Section A, Point 2).

63. **To ensure the independence of ratings, credit rating agencies are required to prevent conflicts of interest and/or to manage these conflicts adequately where they are unavoidable.** They must disclose conflicts of interest in a complete, timely, clear, concise, specific and prominent manner and record all significant threats to the rating agency's independence or that of its employees involved in the credit rating process, together with the safeguards applied to mitigate those threats. They must limit their activity to credit ratings and related operations, excluding consultancy or advisory services (Article 6 and Annex I, Section B). Agencies must have adequate internal policies and procedures to insulate employees involved in credit rating from conflicts of interest and ensure the quality, integrity and thoroughness of the rating and review process at all times. Linked to this, agencies must allocate sufficient employees with appropriate knowledge and experience to their credit rating activity and make appropriate rotation arrangements for analysts and persons approving credit ratings. (Article 6 and Annex I, Section C).

Disclosure

64. **Under the Regulation CRAs are obliged to disclose ratings on a nonselective basis and in a timely manner.** CRAs have to distinguish between ratings for structured products and for traditional products (corporate, sovereign). Specific disclosure requirements apply to unsolicited credit ratings (Article 10).

65. **To ensure that internal processes and procedures are sufficiently transparent, credit rating agencies must publicly disclose some important information, e.g.,** on conflicts of interest, methodologies and key rating assumptions and the general nature of their compensation policy. They must also periodically disclose data on the historical default rates of rating categories and give competent authorities certain elements such as the list of the largest 20 clients by revenue generated from them (Annex I, Section E).

66. **To ensure that relevant, standardised data on credit rating agencies' performance is available to allow market participants to make industry-wide comparisons,** CESR is to create a publicly available central repository for such data (Article 11(2)). Credit rating agencies must publish an annual transparency report (Article 12 and Annex I, Section E, Part III), and keep records of their activities (Annex I, Section B, Points 7–9).

Confidential information

67. **Credit rating agencies must ensure that employees directly involved in the credit-rating process must, among other things, take reasonable measures** to protect property and records from fraud, theft or misuse; keep confidential any information about credit ratings or possible future credit ratings, except to the rated entity or its related third party; keep confidential information entrusted to the credit rating agency confidential from employees of any person directly or indirectly linked to it by control; refrain from using confidential information for the purpose of trading financial instruments, or for any other purpose except the conduct of the business of credit rating agency.

Hedge funds

Principle 28: Regulation should ensure that hedge funds and/or hedge fund managers/advisers are subject to appropriate oversight.

68. **The FSA has had in place for some time an authorization and reporting regime for hedge fund managers/advisors.** The FSA regulates the hedge fund managers/advisors, but not the funds themselves.

69. **Hedge fund managers/advisors, like all other firms, must comply with the “Threshold Conditions” on an ongoing basis (FSMA Schedule 6).** They are also subject to the FSA Handbook rules on conduct of business (COBS), systems and controls rules,

(SYSC), principles of business (PRIN) and prudential requirements (BIPRU). Hedge fund managers/advisors are risk-profiled and medium and high-impact firms are subject to ARROW reviews. The FSA has the same powers to act in cases of noncompliance as it has with any regulated firm.

70. Prime brokerage activity is subject to oversight and prudential controls—both large global banks and investment banks are regulated by the FSA.