

Spotlight Test: Compliance Worked Solutions

AUTHORISATION & CONDUCT OF BUSINESS

Question 1

Which reason might a corporate treasurer credibly give to explain to his Finance Director why his company is, quite correctly, not required to seek authorisation for regulated activities from the Financial Services Authority (FSA) in respect of treasury activities?

- (a) The responsibilities of the FSA only apply to banks
- (b) The group treasury function has no retail customers
- (c) The group treasury function is relying on the pure risk management exemption and the group company exclusion set out in the FSA Handbook
- (d) Nobody from the FSA has contacted him to ask about what treasury is doing
- (e) Don't know

Answer

The correct answer is (c) The group treasury function is relying on the pure risk management exemption and the group company exclusion set out in the FSA Handbook

The FSA has jurisdiction over investment business in the UK within the scope of specified investments and regulated activities. The classification of counterparties as retail investors is not relevant and authorised persons can include individuals and corporates as well as banks. The onus is on the applicant to seek authorisation (where required) prior to carrying out regulated investment business.

For corporate treasuries, not all transactions will be in specified investments. For example, futures, options and negotiable securities would be included in the definition of specified investments whilst spot FX deals would not (this is also relevant for Codes of Conduct, see question 2 below). However, in most treasuries, some transaction types will fall with the specified investment definition. In respect of "regulated activities" (or the types of business involving specified investments which require authorisation), the definition includes an exemption for pure risk management activity by an entity which would otherwise be non-regulated. This clause exempts the majority of mainstream corporate treasuries from the need to be authorised. In addition, in cases where a corporate treasury manages transactions on behalf of subsidiary companies in its group, there is an additional exclusion for group company activity covering both specified investments and regulated activities.

FSA Handbook web references:

Specified investments: <http://www.fsa.gov.uk/vhb/html/AUTH/AUTH2.6.html>

Risk management exemption: <http://www.fsa.gov.uk/vhb/html/AUTH/auth2.8.html>

Group exemption: <http://www.fsa.gov.uk/vhb/html/AUTH/auth2.9.html>

Disclaimer: *Please note that this question is intended only to highlight particular aspects of the FSA authorisation regime and should not be regarded as comprehensive or as providing specific legal advice. Treasurers considering the application of the FSMA 2000 and other legislation to their treasury activities should always seek independent legal advice.*

Question 2

Which code of conduct governs standards of behaviour in the London wholesale markets for deposits, short term loans and foreign exchange transactions?

- (a) The FSA Conduct of Business Sourcebook (COBS)
- (b) The FSA Inter-professional Code (IPC)
- (c) The Bank of England Non- Investment Product Code (NIPS)
- (d) The London Code of Conduct (LCC)
- (e) Don't know

Answer

The correct answer is (c) The Bank of England NIPS code.

The COBS governs transactions between authorised firms and end-users for investment products such as CDs, CP, equities and bonds. The IPC governs transactions between market counterparties, usually authorised financial institutions and very large companies. The LCC has now been withdrawn and replaced by the IPC and NIPS.

For a useful introduction to Codes of Conduct, please refer to the Treasury Essentials article by Brian Welch in the February 2003 edition of "The Treasurer", p.29.

Web references:

NIPS Code pdf download: <http://www.bankofengland.co.uk/markets/nipscode.pdf>

FSA IPC : <http://www.fsa.gov.uk/vhb/html/MAR/MAR3.1.html>

FSA COBS : <http://www.fsa.gov.uk/vhb/html/cob/COBtoc.html>

Question 3

The Financial Services Authority COBS allows a corporate treasury classified as an "intermediate customer" to 'opt up' to the status of market counterparty if the

company (or any other group company) either has a called up share capital of \geq £10m, or satisfies which of the following criteria?

- (a) Balance sheet \geq EUR 12.5M, net turnover \geq EUR 25M and average employees \geq 250
- (b) Balance sheet \geq EUR 12.5M
- (c) Net turnover \geq EUR 25M
- (d) Any two of the three tests in (a) above
- (e) Don't know

Answer

The correct answer is (d) Any two of the three tests in (a) above.

See COBS 4.1.12 at <http://www.fsa.gov.uk/vhb/html/COB/COB4.1.html>.

The ACT took part in the Committee of European Securities Regulators consultation on the harmonisation of these and other conduct of business standards across the EU. For a copy of the Association's response, please visit www.treasurers.org/treasury_resources/CESR_1101.cfm.

END-USERS OF FINANCIAL INSTRUMENTS

Question 4

The international think-tank, the Group of Thirty (G30) produced a set of recommendations for the management of derivatives risks. What advice was specifically aimed at end-users (as included in Recommendation 9)?

- (a) That end-users should consider regularly marking to market derivative positions
- (b) That end-users should periodically forecast the cash requirements for funding derivative positions
- (c) That end-users should establish a clearly independent and authoritative function to design, and assure adherence to, prudent risk limits
- (d) All of the above
- (e) Don't know

Answer

The correct answer is (d) All of the above.

The Group of Thirty, established in 1978, is a private, non-profit, international body composed of senior representatives of the private and public sectors and academia. It aims to deepen understanding of international economic and financial

issues and to examine the choices available to market practitioners and policymakers.

To download a summary of the full 24 derivative risk recommendations, visit <http://risk.ifci.ch/138250.htm>.

The Futures & Options Association also publishes guidelines on using derivatives which are endorsed by the ACT. To download these guidelines, go to <http://www.foa.co.uk/publications/index.jsp>.

MARKET ABUSE & FINANCIAL CRIME

Question 5

What penalty is imposed on individuals under the Criminal Justice Act 1993 for failing to report a transaction suspected to be linked to drug trafficking or terrorist funds, or for tipping off a suspected money launderer?

- (a) An unlimited fine
- (b) Up to three years' imprisonment and/or an unlimited fine
- (c) Up to five years' imprisonment and/or an unlimited fine
- (d) Up to ten years' imprisonment and/or an unlimited fine
- (e) Don't know

Answer

The correct answer is (c) Up to five years' imprisonment and/or an unlimited fine.

For the text of the Criminal Justice Act 1993, go to http://www.hmso.gov.uk/acts/acts1993/Ukpga_19930036_en_1.htm

Corporate treasuries which are authorised to undertake regulated activities by the FSA should also be aware of corporate money laundering prevention obligations under the Money Laundering Regulations 1993 and 2001 which are currently undergoing a revision process to incorporate the Second EU Money Laundering Directive. For a copy of current regulations, visit <http://www.hmso.gov.uk/si/si2001/20013641.htm>.

Question 6

Which of the following regulations on insider dealing and market manipulation attract criminal penalties for non-compliance?

- (a) Financial Services & Markets Act 2000, s.397 (Market Manipulation)
- (b) Financial Services & Markets Act 2000, s.118 (Market Abuse)
- (c) UK Listing Rules (Price Sensitive Data and Directors' Dealing Codes)
- (d) All of the above

- (e) Don't know

Answer

The correct answer is (a) Financial Services & Markets Act 2000, s.397 (Market Manipulation)

S.118 of FSMA sets out the civil law penalties for market abuse as implemented and monitored by the FSA. The Code for Price Sensitive Data and the Model Code for Directors' Dealing represent best practice guidance but do not attract criminal penalties for breach. Criminal penalties also apply to breaches of the insider dealing regulations under the Criminal Justice Act 1993.

Web references:

FSMA 2000: <http://www.hmso.gov.uk/acts/acts2000/20000008.htm>

Listing Rules Model Code: <http://www.fsa.gov.uk/pubs/ukla/chapt16-3.pdf>

Question 7

In relation to the market abuse civil regime, which practices have been designated by the FSA as “safe harbours” (or areas where compliance with specified rules will not constitute market abuse)?

- (a) Price stabilisation rules
- (b) Chinese Walls
- (c) Certain specified provisions of the Takeover Code and the Listing Rules
- (d) All of the above
- (e) Don't know

Answer

The correct answer is (d) All of the above.

Safe Harbours are noted with symbol © in the Market Conduct Source Book (see, for example, <http://www.fsa.gov.uk/vhb/html/MAR/MAR1.7.html> and <http://www.fsa.gov.uk/vhb/html/MAR/MAR1.4.html>).

CORPORATE FINANCE RELATED COMPLIANCE

Question 8

The Companies Act 1985 (s.198) [as amended by the Disclosure of Interest in Shares (Amendment) Regulations 1993] requires that a person who acquires or ceases to hold a “material beneficial interest” in a publicly listed company must disclose this to the company concerned within two business days. What is the stated definition of a material beneficial interest?

- (a) 3% of the issued share capital or an increase/decrease across 1 full percentage point when 3% or more of the share capital is already held
- (b) 3% of the issued share capital or an increase/decrease across 2 full percentage points when 3% or more of the share capital is already held
- (c) 5% of the issued share capital or an increase/decrease across 1 full percentage point when 5% or more of the share capital is already held
- (d) 5% of the issued share capital or an increase/decrease across 2 full percentage points when 5% or more of the share capital is already held
- (e) Don't know

Answer

The correct answer is (a) 3% of the issued share capital and /or an increase/decrease across 1 full percentage point when 3% or more of the share capital is already held.

Question 9

Which body oversees the conduct of merger and acquisition activity for all public companies and certain private companies in the UK, Channel Islands and Isle of Man?

- (a) The Bank of England
- (b) City Panel on Takeovers & Mergers
- (c) Financial Services Authority
- (d) The London Stock Exchange
- (e) Don't know

Answer

The correct answer is (b) The City Panel on Takeovers and Mergers.

The Panel is made up of representatives from all the important professional bodies and authorities in the City of London including the Bank of England, the FSA and The Stock Exchange. The Panel is charged with ensuring adherence to the general principles set out in the City Code. It performs a self regulatory function which

employs the sanction of removing the facilities of the City from those in breach of the Code. Visit their website at <http://www.thetakeoverpanel.org.uk/> where the City Code is also available.

For more detail, please also refer to MCT study materials, Manual VII, Chapter 7.

Question 10

After an announcement of a firm intention to make a bid for a company covered by the City Code, within how many days should the offer document be posted?

- (a) 7 days
- (b) 14 days
- (c) 21 days
- (d) 28 days
- (e) Don't know

Answer

The correct answer is (d) 28 days.

See Rule 30.1 of the City Code available at <http://www.thetakeoverpanel.org.uk/>.

To learn more about regulation and compliance for the corporate treasurer, why not consider the MCT qualification which covers these issues as part of Paper VII Corporate Finance and Paper IX Treasury Management.