



DIPLOMA SUMMER 2008 EXAMINATION

REGULATION AND COMPLIANCE

DATE OF EXAM	Tuesday 24 June 2008
3 Hrs 15 mins	10.00 am – 1.15 pm
RUBRIC	SECTION A - <i>ALL</i> questions in this section are to be answered SECTION B – Answer <i>QUESTION 11</i> and <i>ONE</i> other in this section SECTION C – <i>TWO</i> questions in this section are to be answered

Candidates are reminded that no marks will be awarded for illegible work

NOTES TO CANDIDATES

1. Please insert your Candidate Number on the cover of your Answer Book. *Do not insert your name.*
2. Show *all* workings in your Answer Book.
3. Candidates may attempt the sections in any order. Please indicate clearly in your Answer Book which questions you are answering.
4. Please insert in the box provided on the cover of your Answer Book the numbers of the questions you have attempted in the order in which they appear in the Answer Book.
5. You may use the calculator provided or one approved by the Securities & Investment Institute.
6. You must hand your Answer Book to an invigilator before you leave the Examination Hall. *Failure to do so will result in disqualification.*
7. The decision of the panel is final and no correspondence will be entered into concerning the grade awarded.
8. Once submitted, the examination scripts become the property of the Securities & Investment Institute and will not be returned to candidates.

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PLEASE TURN OVER WHEN INSTRUCTED

USE ANSWER BOOK A FOR THIS SECTION**Answer ALL questions in this section**

- 1 Identify the main threshold conditions set out in Schedule 6 of the Financial Services and Markets Act (FSMA). *(3 marks)*
- 2 Identify six exceptions under the Financial Promotions Order (FPO) for breach of the restriction on the issuance of financial promotions under s21 of the FSMA. *(3 marks)*
- 3 List the four categories of authorised person under the FSMA. *(3 marks)*
- 4 Identify the eight regulated activities outlined in Schedule 2 FSMA. *(3 marks)*
- 5 List the main general principles (in summary) contained in the City Panel's Code on Takeovers and Mergers Code. *(3 marks)*
- 6 Explain the functions of the FSA as the competent authority for the listing of securities (UKLA) under the FSMA. *(3 marks)*
- 7 Specify the penalties that apply for breach of the prohibition on market abuse in s118 FSMA. *(3 marks)*
- 8 List six supervisory tools set out in SUP within the FSA's Handbook of Rules and Guidance. *(3 marks)*
- 9 Identify six of the key requirements set out in SYSC. *(3 marks)*
- 10 What are the six consumer outcomes of the TCF initiative? *(3 marks)*

USE ANSWER BOOK B FOR THIS SECTION**Answer QUESTION 11 and ONE other question in this section**

- 11 A major charitable organisation has set up a small friendly society in the UK to offer a range of products specially designed for children's savings purposes. It will use the £250 child trust fund (CTF) vouchers (£500 for lower income families) provided by the government with separate tax exempt savings plans (TESPs) for older or any other non-qualifying children. CFT contributions are flexible although minimum conditions and amounts apply with regard to TESP contributions. The monies paid in are to be invested in a separate withprofits fund managed by the society with the children receiving the full amount of the contributions made at minimum and additional annual or terminal bonuses earned on the withprofits fund.

A series of TV and newspaper and journal promotions have been prepared for the products with follow-up information packs being sent out to interested parties. Your firm has been instructed to comment on and approve all of the promotional material produced. You are asked to respond to each of the following enquiries:

- a) What basic controls apply with regard to the issuance of financial promotional material in the UK? *(4 marks)*
 - b) What penalties or other consequences may follow from breach of these requirements? *(4 marks)*
 - c) To what extent can these facilities be compared with other similar products or other different types of savings or investment devices and what risk warnings would apply? *(4 marks)*
 - d) What other internal process or management requirements will the society have to comply with? *(4 marks)*
 - e) In your opinion, what other considerations apply with regard to the issuance and distribution of this promotional material? *(4 marks)*
- 12 A major Asian sovereign wealth fund approaches your bank which provides specialist 'boutique' investment services for only 'the most discerning clients.' The fund wishes to build up a high yield 'UK and Euro Zone portfolio'. The following questions are referred to your compliance desk.
- a) How would you classify the fund for COB purposes? *(4 marks)*
 - b) Explain the documentation you would prepare and have executed before any services could be provided or the nature of any services that could be provided immediately. *(4 marks)*

- c) The fund has been informed that you act for certain major government defence suppliers and asks for advice on the investment opportunities that may be available in this area. How would you respond? *(4 marks)*
- d) The fund representatives from the receive a copy of your monthly research bulletin which refers to some potentially lucrative ‘hidden gems’ and ask to speak to staff who prepared the relevant reports and your front traders. Should you allow this? *(4 marks)*
- e) The representatives also ask what, if any, dealing commissions your firm is allowed to charge. Explain the main restrictions that would apply in general terms. *(4 marks)*

13 One of the rich private clients of a leading United Kingdom investment bank has become increasingly dissatisfied with the quality of the service provided. You are instructed to advise the client on any rights of redress or recovery that may be available against the firm. You are asked, in particular, to comment on the following:

- a) The client considers that it has been given the wrong advice with regard to some of the investments made as a result of which a significant amount of money has been lost especially in Asian equity and derivatives holdings. Advise the client on what action should initially be taken. *(4 marks)*
- b) Having obtained further information from another client of the firm as to the firm’s knowledge of the weak prospects of the markets concerned and following the firm’s failure to provide any satisfactory explanation, you are asked to explain if any further rights of complaint are available. *(4 marks)*
- c) The client is then informed that the losses suffered have actually resulted from the fraudulent dealings of the unsupervised office manager in Bangkok. How should the client proceed? *(4 marks)*
- d) Following a separate investigation into the activities of the office manager, the FSA becomes aware of the extent of the loss. Can it assist the client in any way with regard to the losses suffered? *(4 marks)*
- e) In the event of the firm’s subsequent collapse and closure, does the client have any separate right of claim apart from against the firm directly which is now in insolvency? *(4 marks)*

14 You are the compliance officer responsible for trade monitoring in a small to medium sized firm. The proprietary desk runs several books, grouped according to sector type. The trading strategies allow for both long and short positions to be taken. There is an institutional and retail client sales desk. The firm also produces investment research which is made available to the proprietary desk 24 hours after distribution to clients. All trading and sales staff are located on the same floor. The research analysts are located away from trading staff. The market is nervous about a

series of losses announced by banks and other financial institutions primarily due to the subprime mortgage market.

One day, approximately half an hour after the market's opening, several purchases of stock in financial institutions and several short sales are made by the proprietary desk. One short sale is larger than usual for the book and is in a stock covered by one of the firm's research analysts. The retail client sales desk is quiet as several research reports have been issued that morning. The institutional sales desk has been actively working through large orders to sell stocks in the financial sector.

Late morning the proprietary book is very active in financial institutions and prices are down about 5 % from the market opening. There appear to be more short positions than usual. Execution of some retail client orders has taken place resulting from the research issued that morning. All but one transaction follow the research recommendations made.

Afternoon trading shows again an emphasis on short trades in the financial sector, with a short position in one stock that dropped substantially in price during the course of the day. Long positions appear to be concentrated in any sector other than financial institutions.

Your Compliance monitoring system details records of market prices for all stock traded that day on the exchange and access to all news announcements. The system is a live system and alerts you to variances of price which exceed a 5% movement.

Your initial review of the execution data for trading shows that the transactions carried out were in line with the prevailing market prices. You have been alerted to a substantial price drop in one of the stocks shorted early in the morning.

- a) Is the retail client order executed against a research recommendation something to be concerned about? Discuss. *(5 marks)*
- b) Should the proprietary desk short a stock in which one of the firm's research analysts has recommended a buy? Discuss. *(5 marks)*
- c) You notice that the proprietary desk has taken positions in some stocks for which there were wholesale client sell orders. Is this of concern? *(5 marks)*
- d) The large short position taken by the proprietary desk was taken before a subsequent rapid drop in price. What concerns does this raise with you? *(5 marks)*

USE ANSWER BOOK C FOR THIS SECTION

Answer TWO questions in this section

- 15 Comment on the effectiveness of the accountability regime set up under the FSMA to prevent or contain any abuse of power or procedure by the FSA. *(15 marks)*

- 16 Assess the extent to which the FSA has been able to secure compliance with its statutory objectives as a result of its work in the area of 'Financial Capability'. *(15 marks)*

- 17 "The recent explosive growth of sovereign wealth fund investment presents no significant new regulatory obstacles for the FSA." Discuss. *(15 marks)*

- 18 Comment on the extent to which the UK authorities have been able to learn any significant regulatory lessons from the recent crises in national and international financial markets. *(15 marks)*