

In this month's update:

- Happy Valentines? European Parliament adopts position on draft AIFM
- Global warming "pump and dump" scheme exposed
- FSA announces insider dealing convictions

Happy Valentines? European Parliament adopts position on draft AIFM

- EP proposals "ensure better transparency and investor protection
- Clamp-down on naked short-selling
- New reporting requirements imposed

On January 14th, the European Parliament's Economic and Monetary Affairs Committee adopted its position on the draft EU law regulating managers of alternative investment funds including hedge funds.

In doing so, MEPs voted for new ways to deal with managers and funds located outside the EU and on what it described as "a proportionality system to regulate less risky funds more lightly, and rules on remuneration policies and short selling."

They also claimed to have made improvements to the directive's transparency and risk reduction rules.

Announcing the adoption of the position, rapporteur Jean-Paul Gauzès said it would "ensure better transparency and better investor protection while at the same time being on the side of the financial industry when it is working for the real economy."

Under the legislation as amended by the

committee, alternative investment fund managers (AIFMs) in third countries would need to comply with the directive in order to market funds around the EU. Other funds, including private equity and investment trusts will be more lightly regulated than hedge funds and some other types of alternative investment funds (AIFs) would be completely exempted.

In a statement, the European Parliament said that the main changes put forward by MEPs "are intended to increase investor protection and transparency while at the same time reducing the potentially protectionist dimension of the rules on access to the EU market from the outside."

According to the European Parliament, the adopted text increases the disclosure requirements to investors by AIFMs in some fields and also proposes some new reporting requirements.

For example, new rules would require AIFMs "to inform investors about maximum levels of leverage and the total amount of leverage used by an AIF, and to provide information on the domicile of underlying funds in case of 'fund of funds' AIFs and the domicile of any master fund."

Managers would also be required to provide a description of the past

performance of the AIF, changes in liability if there is a contractual agreement between the AIFM and the depositary, and information about the role of sub-depositaries if these are being used.

The authorities would need to be informed about the overall leverage used for each AIF, the ways fees are paid and the amounts paid to the AIFM, and performance data of the AIF including the valuation of assets. The authorities may ask for additional information from managers which they consider may pose important risks. The European Securities and Markets Authority (ESMA) may also require additional reporting in exceptional circumstances or in order to protect the stability of the financial system.

The committee has also proposed features which, it says, will reduce risk in the financial system - including rules on remuneration, selling of borrowed securities (short-selling) and marketing to retail investors.

On remuneration for example, the text requires that "AIFMs adopt sound policies and practices that do not encourage excessive risk - and it demands that remuneration policies for AIFMs be closely similar to those to be applied to banks."

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A key feature is that the text bans "naked short-selling" - i.e., "selling a security which is neither owned nor borrowed." It also requires managers regularly to disclose information on important short positions to national authorities, and provides that ESMA may decide to restrict short-selling activities in exceptional circumstances or to protect the financial system's stability."

With regard third countries, the European Parliament says that whereas the European Commission had proposed a system based on equivalence, "If the Commission considered the legal system of a third country equivalent to that of the system set out in the AIFM directive, then the funds and fund managers of that country would have access to the EU... In view of the implementation problems this method could cause, the EP text puts forward a different approach. In the case of access of AIFMs to the EU markets it provides that a non-EU AIFM would have to voluntarily subject itself to the directive's requirements. In such cases the financial supervisors of that third country would have to act as agents to ESMA in the supervision of that manager."

Hedgies unconvinced

A [survey](#) of hedge fund managers conducted before the EP position vote revealed their opposition to proposed short-sale disclosure requirements, with managers predicting that the regime might distort financial markets and reduce their ability to manage risk.

According to the study, a key concern was that public disclosure of individual short positions would limit corporate management access - which it described as a "key investment decision input for investors."

Managers had already experienced such challenges in jurisdictions that had implemented the proposals in the EU to date. In addition, they expected that unsophisticated investors would "mimic trades in the market without a full understanding of the strategy."

It also concluded that a regulatory regime based on the disclosure of individual managers' net short positions above a threshold of 0.5% of outstanding share capital "is not effective in meeting the needs of the public, regulators or industry participants", and that there was evidence to suggest that such disclosure requirements result in "lower market liquidity, and an increased likelihood of short squeezes [and that]...overall, the benefits of these disclosure requirements seem negligible in comparison with the increases in the cost of capital and the associated negative impact on the real economy."

Global warming "pump and dump" scheme exposed

- Fraudsters sold shares in "anti-global warming" company
- Lawyer amongst those charged for writing fraudulent opinion

The US Securities and Exchange Commission says that it has charged a group of seven individuals who perpetrated a fraudulent "pump-and-dump scheme" in the stock of a sham company that purported to provide products and services to fight global warming.

The SEC said the group "included stock promoters, traders, and a lawyer who wrote a fraudulent opinion letter," and resulted in more than \$7 million in illicit profits from sales of stock at artificially inflated prices.

It said that despite touting impressive business relationships and anti-global warming technology innovations, "CO2 Tech did not have any significant assets or operations. The company was purportedly based in London," while its share prices were quoted in the financial press."

The SEC's [complaint](#) says that the scheme was perpetrated through Red Sea Management Ltd., a Costa Rican asset protection company that laundered millions of dollars in illicit trading proceeds out of the United States on behalf of its clients.

"This group of illicit stock promoters sought to hide their scheme behind offshore entities, but their misconduct was exposed by the excellent cooperation of law enforcement agencies here and abroad," said Cheryl Scarborough, associate director in the SEC's Division of Enforcement.

FSA announces insider dealing convictions

- Three receive custodial sentences and fines
- Traded over eight years in LSE and AIM shares
- "Rogue traders must be made to pay" says Judge

Three people, an investment banker, his wife and a family friend, were convicted of insider dealing by the UK High Court and received custodial sentences, the Financial Services Authority announced in a statement, February 2nd.

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It said that Christian Littlewood, a senior investment banker and former Financial Services Authority (FSA) Approved Person, his wife Angie Littlewood (also known as Siew Yoon Lew and Angie Lew) and a family friend, Helmy Omar Sa'aid, have today been sentenced for insider dealing contrary to section 52 of the Criminal Justice Act 1993.

Christian Littlewood was sentenced to three years and four months in custody; Angie Littlewood was sentenced to twelve months in custody suspended for two years; and Helmy Omar Sa'aid was sentenced to two years in custody.

Sa'aid was also ordered to pay £640,000 in confiscation. Confiscation orders in relation to Christian and Angie Littlewood will be dealt with at a later date. The trio pleaded guilty to eight counts of insider dealing related to trading in a number of different London Stock Exchange and AIM listed shares between 2000 and 2008.

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In passing sentence His Honour, Judge Leonard QC, noted that sentences need to deter others:

"Those rogue traders that let down the honest, discreet majority must be made to pay."

Margaret Cole, managing director of enforcement and financial crime, said:

"This was a case of systematic abuse by an approved person of their privileged position in the market - we are determined to stamp out such abuse. Our tough, coordinated

approach to insider dealing and our commitment to taking on difficult criminal prosecutions has really begun to pay off; the guilty pleas and sentencing of the Littlewoods and Sa'aid shows that we can, and will, uncover insider dealing, even across borders, and that the people who commit these market offences will not go unpunished."

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