

Morgan Lewis

a summary of the Financial Services Authority's  
**enforcement procedures**  
in the United Kingdom



## INTRODUCTION

### Scope of the FSA's Powers

The Financial Services and Markets Act 2000 (“FSMA”) gives the FSA significant powers to impose a variety of sanctions on firms and individuals for breaches of rules under FSMA and other legislation. The FSA can publicly censure or impose a financial penalty on any investment business or individual that has contravened a FSMA requirement. Any financial penalty imposed by the FSA is ordinarily accompanied by a press release. The FSA has the further power to withdraw approval for an individual to perform significant investment business functions or to prohibit an individual from working in an investment business at all.

Generally, the FSA’s enforcement process only affects “authorised persons” (i.e. firms regulated by the FSA) and “approved persons” (i.e. individuals regulated by the FSA). The FSA can, however, also take action against other persons, for example in relation to market abuse and breaches of the Listing Rules.

Between December 2001 and July 2005, there were 106 enforcement actions taken by the FSA which resulted in a published disciplinary outcome, involving 50 authorised firms, 38 approved persons and eight listed companies. There is perhaps a general perception that the FSA imposes significant fines on firms subject to disciplinary review. Certainly, the FSA has imposed high fines on some firms, for example the FSA imposed £17 million on Shell<sup>1</sup> in 2004 for market abuse arising from the misreporting of its oil reserves and in 2005 the FSA imposed £13.9 million on Citigroup<sup>2</sup> for behaviour the FSA perceived as amounting to market abuse.

Whilst it is correct that the FSA has imposed some significant fines that have been higher than those imposed by its predecessors, average penalties imposed remains low in comparison to those awarded by securities regulators in the US. The United States Securities and Exchange Commission (SEC), for example, which has long been recognised as an-enforcement led regulator, brought more than 1,300 enforcement actions and obtained orders for penalties and disgorgements totaling a record \$5 billion in just two fiscal years, 2002 and 2003.

A person who engages in conduct, for which the FSA can take enforcement action, may also find that it is in breach of the provisions of the criminal law. FSMA gives the FSA power to prosecute a number of criminal offences and market misconduct under FSMA and other legislation. The criminal offences for which the FSA can take action are broad and include offences relating to breaches of the Listing Rules (for example, that of offering new securities to the public in the UK before publishing a prospectus if required by listing rules made under section 84, FSMA), insider dealing, market manipulation and making misleading statements to the market.

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<sup>1</sup> Final Notice, The Shell Transport and Trading Company Plc, 24 August 2004

<sup>2</sup> Final Notice, Citigroup Global Markets Limited, 28 June 2005

## The FSA's Approach to Enforcement

The cases and circumstances in which the FSA will opt for disciplinary action are set out in the FSA's Enforcement Manual. In many cases, non-compliance is addressed without recourse to disciplinary or other enforcement action. The FSA represents that it focuses on regulation and day-to-day supervision and maintains that it looks on enforcement only as a last resort where, for example, a firm, despite receipt of supervisory guidance, nonetheless repeatedly acts in breach of the rules. The FSA aims to select cases to formally investigate according to their seriousness and how they fit within its priorities. There is, however, a concern, especially in relation to its priority policy areas, that the FSA may follow the SEC's example and resort to enforcement without any preceding attempt to remedy perceived shortcomings of a member firm through the supervisory process.

Between December 2001 and July 2005, the great majority of enforcement cases were in a priority policy area. Historically, and based on general policy comments from the FSA, the FSA's priorities for wholesale markets have been (and are likely to remain) market abuse (e.g. insider dealing) and breaches of the Listing Rules. For retail markets, the priorities are mis-selling and financial promotion. Even where a particular issue is not at the top of the FSA's current list of priorities, some situations may be so serious that the FSA will consider that a full investigation must take place followed by any disciplinary action, if warranted.

The FSA has stated that, where it considers that behaviour justifies criminal rather than civil penalties, the FSA will be prepared to pursue such cases through the criminal courts. The FSA demonstrated its commitment and ability to do so in 2005 by the successful prosecution of the directors of AIT for making misleading statements to the markets.

The FSA has stated that one of its key priorities is that it expects senior management to take responsibility for ensuring that firms identify risk, have appropriate systems and controls in place to mitigate them and ensure that these actually work in practice. Where individuals are themselves responsible for misconduct, whether that of their own or that of others, the FSA has stated that it will bring cases against those individuals, in addition to any action against the firm. Generally, cases against individuals are hard fought, are harder to prove, take longer to resolve and are less likely to be settled. It is perhaps for these reasons that, to date, there have been few successful actions against individuals by the FSA. Nonetheless, the FSA has stated that it is committed to ensuring that appropriate cases against senior management are pursued robustly and with sufficient resources.

## Scope of this Publication

This publication sets out some general guidance as to what firms and individuals may expect and the procedures to be followed in the event that the FSA initiates enforcement actions against them, regardless of whether the case fits into an FSA priority area. The guidance takes into account the recent changes to the FSA's enforcement procedures, which were implemented in October 2005 by the FSA, in order to make the enforcement process more transparent and fair. The changes reflect the recommendations of the FSA's Enforcement Process Review, published in the summer of 2005, which was commissioned after aspects of the FSA's enforcement process were criticised by the FSMA Tribunal and because many firms and individuals had doubts about the fairness of the process. In summary, the following key changes were made:

- Investigations undertaken by the FSA must now be of a consistently high standard and any breaches must be properly supported by evidence. Before a case is referred to the FSA's decision-makers (the Regulatory Decisions Committee - the "RDC"), there should be a thorough legal review by lawyers in the Enforcement division who are not part of the investigation team.
- The previous practice whereby enforcement staff had direct access to the RDC after the conclusion of any hearings, without the firm or individual being present, has ended. Additionally, any substantive communications between enforcement staff and the RDC must now be disclosed to the firm/individual.
- There is an explicit discount system for those who settle their cases early in the proceedings (ranging from 30% to 5% of the total fine).
- The previous practice whereby the RDC was involved in settlement negotiations and approved the terms of any settlement has ended. Settlement decisions are now the sole preserve of senior FSA enforcement staff and/or the FSA's Executive.

Morgan Lewis has one of the largest and longest established securities regulatory enforcement practices in Washington, D.C. and New York. Morgan Lewis has now also established a securities regulatory enforcement practice in London to assist firms with the development of compliance systems and controls and the handling of enforcement investigations and proceedings in the United Kingdom, whether initiated by the FSA or Recognised Investment Exchanges, or by overseas regulators such as the SEC.

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## FSA DECISION TO COMMENCE AN ENFORCEMENT INVESTIGATION

FSA Principle 11 requires a regulated firm to deal with its regulators in an open and co-operative way, and disclose to the FSA anything relating to the firm of which the FSA would reasonably expect notice. Thus, whenever a firm identifies a material breach of FSA rules that implies a weakness in its compliance systems and controls (for example, as a result of an internal audit review or a compliance monitoring program or whistle-blowing threats from a disgruntled ex-employee), it is obliged to report the matter to the FSA. (While in the United States firms regulated by the SEC are not subject to a general mandatory obligation to self-report, the SEC has nonetheless made it clear that a failure to self-report serious violations which are subsequently identified by the SEC may result in a significantly greater enforcement penalty than otherwise would have been the case.) Alternatively, a material FSA rule contravention may come to the FSA's attention in the course of a supervisory visit or be identified by one of the FSA's specialist monitoring units.

The FSA has extensive investigatory powers which it may exercise prior to making a determination upon whether the commencement of proceedings is appropriate. The enforcement process may include disciplinary proceedings; criminal court proceedings; civil court proceedings for an injunction or a restitution order (in the case of regulated firms, restitution proceedings would normally be combined with disciplinary or criminal proceedings); or bankruptcy or winding-up proceedings.

### The FSA's powers to gather information and investigate

In carrying out its supervisory and enforcement functions (or in supporting investigations by overseas regulators), the FSA may require a firm to provide information and documents within a period of time the FSA deems reasonable. If the information available to the FSA raises a regulatory concern about a firm, the FSA may make further enquiries, using its powers to require reports by skilled persons (for example, an independent firm of accountants) or to appoint investigators (usually staff members of the FSA Enforcement Division). In some circumstances, a report provided by a skilled person may not be appropriate, or may be insufficient (because of the limited nature of the power) to address the seriousness of the FSA's concerns. This will include cases where an effective and thorough investigation by the FSA is likely to call for the exercise of powers to require the firm to answer questions and/or produce documents. In those cases, the FSA will appoint an investigator; if appropriate, the FSA may also require the firm to provide a skilled person's report. In other cases, the FSA may appoint an investigator as a result of information in a skilled person's report.

## Legal Privilege, Banking Confidentiality, and Admissibility

A firm cannot be required to produce, disclose or allow inspection of legally privileged documents (i.e., documents made in connection with the giving of legal advice to the firm, or in connection with or in contemplation of legal proceedings).

Further, no firm can be required to give information or produce a document with respect to which it owes an obligation of confidentiality by carrying on banking business unless:

- 1) the company or person to whom the obligation of confidentiality is owed is the company or person under investigation, or a related company; or
- 2) the company or person to whom the duty is owed consents to the disclosure; or
- 3) the requirement to disclose has been specifically authorised by the FSA.

### The FSA's policy: interviews and interview procedures

The FSA may not always use its statutory powers to require individuals to submit to interviews. If appropriate, the investigator will first seek to conduct interviews on a voluntary basis. If the interviewee is the subject of the investigation, the investigator will make a record of the interview and the FSA will give a copy of the record to the interviewee. If the interviewee is not the subject of the investigation, the FSA will give the interviewee a record of the interview if one has been made by the investigator. The interviewee may be accompanied by a legal adviser, if he or she so wishes.

Where the FSA does require a person to answer questions in an interview, using its compulsory powers it will:

- 1) allow that person (whether or not he or she is the subject of the investigation) to be accompanied by a legal adviser, if he or she so wishes;
- 2) give the person an appropriate warning and an explanation of the limited use that can be made of his or her answers in criminal proceedings against him or her, or in proceedings in which the FSA seeks a penalty for market abuse; and
- 3) give the person a record of the interview (in most cases this will be an audio tape recording).

Generally, a statement made by a person to an investigator in compliance with an information requirement (for example, the requirement to provide information imposed by an investigator under FSMA), is admissible in evidence in any proceedings (whether criminal or civil and subject to any procedural rules relating to the admissibility of evidence). However, such statements are not admissible in criminal proceedings or proceedings

for market abuse (see Morgan Lewis' brochure on the Market Abuse, April 2006) against the person who made the statement, in that:

- no evidence relating to the statement may be adduced; and
- no question relating to it may be asked;

by or on behalf of the prosecution, or the FSA, unless evidence relating to it is adduced, or a question relating to it, is asked in the proceedings by, or on behalf of, the person who gave it (s174, FSMA). This is subject to the exception that the statement may be used in criminal proceedings for perjury or for the criminal offences under FSMA of providing false or misleading information to the FSA.

The FSA is a prosecuting authority in England and Wales and Northern Ireland for a number of criminal offences. When conducting interviews with suspects for the purpose of obtaining evidence for use in criminal proceedings, investigators are subject (with appropriate adaptations) to the statutory requirements of the Police and Criminal Evidence Act 1984 (PACE) and its Codes, and of the Criminal Procedure and Investigations Act 1996. An individual suspected of a criminal offence may therefore be interviewed under caution. The FSA will warn the suspect at the start of the interview of his or her right to remain silent (and the consequences of remaining silent) and will inform the suspect that he or she is entitled to have a legal adviser present.

If a suspect has already been interviewed by the FSA under compulsory powers, before he or she is interviewed under caution, the investigators will give the suspect the transcript or other record of the compulsory interview and an explanation of the difference between the two types of interviews. They will also tell the individual about the limited use that can be made of his or her previous answers in criminal proceedings or in proceedings in which the FSA seeks a penalty for market abuse.

Also, where a suspect has been interviewed under caution, and the FSA subsequently wishes to conduct a compulsory interview with him or her, the FSA will again explain the difference between the two types of interviews, and will notify the individual of the limited use that can be made of his or her answers in the compulsory interview.

## Publicity

The FSA will not normally make public the fact that it is or is not investigating a particular matter, or any of the findings or conclusions of an investigation.

Where it is investigating a matter, the FSA will, in exceptional circumstances, make a public announcement that it is doing so if it considers that such an announcement is necessary to:

- 1) maintain public confidence in the financial system;
- 2) protect consumers;
- 3) prevent widespread malpractice; or

- 4) help the investigation itself (for example, by bringing forward witnesses).

The FSA is most likely to consider that circumstances justify a public announcement when a matter has already been widely speculated upon by the press.

## Preliminary Findings Letter

Unless it is not practicable to do so (such as in cases of urgency), the FSA staff will generally send a preliminary findings letter to a firm before considering whether to recommend that enforcement action be initiated. The letter will set out the facts that the FSA staff (or the investigator appointed by the FSA) consider relevant to the matters under investigation, and will invite the senior management of the firm concerned to confirm that those facts are complete and accurate. The FSA staff (or the investigator appointed by the FSA) will allow a reasonable period (normally 28 days) for the firm to respond to the letter.

The FSA staff will take into account any response they receive within the period stated in the preliminary findings letter. Although the FSA is not obliged to take into account any response received outside that period, a time extension to respond will normally be granted by the FSA if reasonable grounds for requiring further time can be advanced.

Where the FSA has sent a preliminary findings letter and then decides not to take any further action, it will communicate this decision promptly to the firm concerned.

## Preparation and Advice

A firm should not wait until it has received a preliminary findings letter to involve its legal department and legal advisers. Indeed, the FSA anticipates, and certainly does not discourage, the participation of lawyers at the initial scoping stages of an investigation. It is important to provide the FSA with a proper appreciation of issues in their context and to present matters in a firm's favour well before the FSA begins drafting the preliminary findings letter. Early involvement of advisers can save on a lot of painful repair work subsequently and can ameliorate the gravity of proceedings generally. The individuals involved should be carefully taken through all the facts and matters relevant to the issues that have arisen with plenty of time to consider any relevant documentation. The imperative of co-operation with the FSA should not be confused with unthinking concessions to the allegations made, or treated as a reason for not investing effort to positively promote a case that may justify the firm's actions (or at least mitigate the seriousness with which the FSA may otherwise initially view the matter). The FSA acknowledges (para 7.13) that a firm can contest both the FSA's views about there having been a breach of principles or rules and any proposed penalty, and still have co-operated in other ways (for example, by being willing early on to establish the facts).

A firm will need to determine to what extent it involves external lawyers. The principal reasons for using in-house counsel are their greater familiarity with the firm's business practices and personnel, the desire to minimise interference with the normal operations of the business and a need to minimise expenditure for legal fees. The principal reasons for using external lawyers, particularly where alleged or suspected misconduct by employees is involved, are the need to complete the investigation within a time frame or in a depth that is beyond the resources of in-house counsel, the avoidance of actual or potential conflicts of interest or other personal inhibitions that in-house counsel might experience, a greater ability to structure the investigation in a manner best calculated to preserve legal privilege protection against the disclosure of confidential documents, and the greater appearance of independence and objectivity that external counsel's work will have. Indeed, the early appointment of independent professional advisers can frequently work to persuade the FSA that it is not necessary to have the formal and intrusive statutory appointment of a skilled person (usually a firm of accountants, lawyers or actuaries nominated or approved by the FSA for the purpose of gathering information or conducting an investigation).

Regardless of whether in-house or external lawyers perform an investigation, it is important to maintain the integrity of the investigation and the legal protection that may be available to its findings. Accordingly, where possible, a firm's lawyers (in-house or external) should be made responsible for the conduct of an investigation with clearly documented terms of reference. Senior management should be discouraged from initiating non-privileged fact-gathering such as by demanding immediate answers directly from junior management, and documents generated by the investigation, such as witness statements, should be marked privileged.

## FSA DECISION TO TAKE ENFORCEMENT ACTION

In the majority of cases, the FSA addresses actual and potential risks and rule breaches through the supervisory process rather than enforcement action. As a risk-based regulator with limited resources, the FSA focuses enforcement resources upon priority areas and on the basis of how important they are for maintaining standards within the regulatory regime. Nonetheless, if significant issues are found (for example, through the FSA's thematic work or a referral from a firm's supervisor), or where behaviour is particularly extreme and where the interest of consumers cannot be protected by any other means, these will be considered for referral to enforcement.

In the FSA's Business Plan for 2005/2006 (Chief Executive Officer's Overview), the FSA stated:

*"We will continue to seek to change behaviour, both of the individuals who commit breaches and in the markets generally through the use in appropriate cases of enforcement tools such as fines, censure and prohibitions. Ensuring that individuals in senior positions of responsibility are held to account when their behaviour falls below acceptable standards is, in our view, the key to achieving the corporate culture required to keep our markets fair and orderly and to support fair treatment of retail consumers".*

The principal FSA decision maker with respect to whether any enforcement action should be taken and the appropriate proceedings to be initiated (whether there be disciplinary proceedings, or civil or criminal court proceedings) is the Regulatory Decisions Committee (RDC) of the FSA.

Before a case is referred to the RDC, there will be a legal review of the case by FSA lawyers who have not been part of the investigation team. The precise nature and extent of the review will vary depending on the nature and complexity of the case (the review may even be carried out by external Counsel if a matter is particularly complex). In some instances, a case may be escalated to the FSA's Senior Management if it is high impact, precedent-setting, or requires significant commitment of FSA resources. This gives FSA Senior Management greater involvement in the enforcement process, particularly as to whether a case should be referred to the RDC.

## The Regulatory Decisions Committee

The RDC is appointed by the FSA Board to exercise enforcement decision-making powers on its behalf. The RDC is accountable to the FSA Board for its decisions. The RDC comprises a Chairman, one or more Deputy Chairmen, and other members. The RDC is a body outside the FSA's management structure. Apart from the Chairman, none of the members of the RDC is an FSA employee. The members represent the public interest and comprise current and recently retired practitioners with financial service industry skills and knowledge as well as non-practitioners. The RDC is supported by the RDC Secretariat. The RDC Secretariat is separate from FSA staff involved in making recommendations to the RDC. The RDC Chairman or one of the Deputy Chairman's usually selects RDC members for any particular case based on the appropriate mix of skills and experience required.

## CRIMINAL COURT PROCEEDINGS

The FSA has the power to prosecute a number of criminal offences, including the following:

- carrying on, or purporting to carry on, a regulated activity without authorisation or exemption;
- communicating an invitation or inducement to engage in investment activity in breach of the restrictions on financial promotion;

- issuing an advertisement, or other information specified in the listing rules, without prior approval or authorisation from the competent authority;
- failing to co-operate with, or giving false information to, FSA-appointed investigators;
- making misleading statements and market manipulation offences;
- engaging in insider dealing under Part V of the Criminal Justice Act 1993; and
- breaching the prescribed regulations relating to money laundering.

The FSA has the power to prosecute these offences in England, Wales and Northern Ireland, but not in Scotland. In Scotland, the Crown office remains responsible for prosecutions.

In cases where criminal proceedings have commenced or will be commenced, the FSA may consider whether also to take civil or regulatory action.

## CIVIL COURT PROCEEDINGS

### Injunctions

The FSA has the power to apply to the court for an injunction against a person or firm to restrain or prohibit a breach of any requirement imposed by FSMA, or to restrain or remedy any market abuse, or to restrain a person or firm from disposing of assets.

The FSA recognises that an application for an injunction will have serious consequences for those concerned. The broad test the FSA will apply when it decides whether to seek an injunction is whether the injunction would be the most effective way to deal with the FSA's concerns.

### Restitution Order

The FSA has the power to apply to the court for an order of restitution where a person or firm has breached a requirement of the FSMA or engaged in market abuse.

The FSA will consider exercising its powers to obtain restitution in the light of the facts of each case. When deciding whether to exercise these powers, the FSA will consider other ways that redress might be obtained, and whether it would be more efficient or cost effective to use those means instead. The FSA will also consider proposals by the person or firm concerned to offer redress to any consumers or other persons who have suffered loss, and the adequacy of those proposals, before exercising its powers.

The instances in which the FSA might consider using its powers to obtain restitution for market counterparties are likely to be limited. Many of the rules applicable to retail consumers will not

be relevant to transactions between market counterparties.

## Insolvency Proceedings

The FSA can petition for an administration order or compulsory winding-up order on the grounds that the firm is unable to pay its debts or is likely to become insolvent. The FSA also has the power to petition the court for a compulsory winding-up of a firm on the grounds that it is just and equitable for the entity to be wound up, regardless of whether or not the entity is in a position to pay its debts. The FSA may petition the court in this manner if it considers that the needs of consumers and the public interest require the firm to cease to operate or that a winding-up is necessary to protect consumers' claims and clients' assets.

## FSA DISCIPLINARY ACTION

In determining whether to take administrative disciplinary action in respect of conduct appearing to the FSA to be a breach, the RDC takes the following principal factors into account.

- 1) The nature and seriousness of the suspected breach:
  - whether the breach was deliberate or reckless;
  - the duration and frequency of the breach (including, in relation to a firm, when the breach was identified by those exercising significant influence functions in the firm);
  - the amount of any benefit gained or loss avoided as a result of the breach;
  - whether the breach reveals serious or systemic weaknesses of the management systems or internal controls relating to all or part of the firm's business;
  - the impact of the breach on the orderliness of financial markets, including whether public confidence in those markets has been damaged;
  - the loss, or risk of loss, caused to consumers or other market users;
  - the nature and extent of any financial crime facilitated by, occasioned by or otherwise attributable to the breach; and
  - whether there are a number of smaller issues, which individually may not justify disciplinary action, but which do so when taken collectively.
- 2) The conduct of the firm or the approved person after the breach:
  - how quickly, effectively and completely the firm or approved person brought the breach to the attention of the FSA or another relevant regulatory authority;
  - the degree of co-operation the firm or approved person showed during the investigation of the breach;
  - any remedial steps the firm or approved person has

taken since the breach was identified, including identifying whether consumers have suffered loss and compensating them, taking disciplinary action against staff involved (where appropriate), addressing any systemic failures, and taking action designed to ensure that similar problems do not arise in future; and

- the likelihood that the same type of contravention (whether on the part of the firm, the approved person concerned or others) will recur if no disciplinary action is taken.
- 3) The previous regulatory record of the firm or approved person:
- whether the FSA (or any previous regulator) has taken any previous disciplinary action resulting in adverse findings against the firm or approved person;
  - whether the firm or approved person has previously given any undertakings to the FSA (or any previous regulator) not to do a particular act or engage in particular behavior;
  - whether the FSA (or any previous regulator) has previously taken protective action in respect of the firm, using its own initiative powers, by means of a variation to the scope of its authorisation or otherwise, or has previously requested the firm to take remedial action, and the extent to which such action was taken; and
  - the general compliance history of the firm or approved person, such as whether there have been previous private warnings.
- 4) Previous guidance given by the FSA:
- the FSA will take into account whether any guidance has been issued relating to the behavior in question and, if so, the extent to which the firm or approved person has sought to follow that guidance.
- 5) Action taken by the FSA in previous similar cases:
- the FSA will take account of action which it has taken previously in cases where the breach was the same or similar.
- 6) Action taken by other regulatory authorities:
- where other regulatory authorities propose to take action in respect of the breach which is under consideration by the FSA, or one similar to it, the FSA will consider whether their action would be adequate to address the FSA's concerns, or whether it would be appropriate for the FSA to take its own action as well.

proceedings, it is obliged to follow a statutory notice procedure.

If FSA staff considers that enforcement action is appropriate, they will provide the RDC with an investigation report which recommends to the RDC that a Warning Notice be given. This will usually be disclosed to the firm. The RDC panel, which will typically consist of the Chairman or Deputy plus two others, will consider the FSA staff recommendations with its legal team who are separate from FSA enforcement staff. After considering this, the RDC may decide not to take further action (with or without a private warning) or decide to give a Warning Notice to the person concerned. If the RDC decides to give a Warning Notice to a person, it must state in writing the action that the FSA proposes to take with reasons and whether any secondary material exists that, in the opinion of the FSA, might undermine that decision and to which the person concerned must be allowed access. There are limitations as to what documents a person is entitled to have disclosed to them. The RDC can refuse access to "protected items", for example documents which are legally privileged from disclosure.

## Representations

Any Warning Notice will contain a statement that the person concerned will have a reasonable amount of time (not less than 28 days) in which to make representations to the RDC. After receiving the Warning Notice, if the person concerned considers that the stated period for representations is too short, then he or she may, within 14 days of receiving the Notice, submit a written request to the FSA. In the case of a Warning Notice, this may be appropriate, for example, if a person has entered into or wishes to enter into settlement discussions with FSA staff.

Any written representations should be sent to the FSA at the address stated in the Warning Notice. If he or she so chooses, a person who receives a Warning Notice may make oral representations to the RDC and attend a meeting for that purpose. The opportunity to make representations is the only time a firm or individual has to address the RDC in relation to the FSA's allegations. It is imperative, therefore, that the parties consider making representations as, if no response is received, the RDC may regard the allegations in the Warning Notice as undisputed.

If the person wishes to make oral representations, he or she should send written notification to the FSA at the address stated in the Warning Notice. The notification should be made at least five business days before the end of the period for representations specified in the Notice. The notification should specify the matters on which the person wishes to make oral representations, include an estimate of how much time the person expects the representations to take, and provide the names of any representatives appointed to attend the meeting at which the representations will be made. If, after notifying the FSA of his or her intention to make oral representations, the person chooses not to make those representations, the RDC will nevertheless decide the matter.

## The Statutory Notice Procedure

Where the RDC determines that it is appropriate not to initiate court proceedings, but to commence administrative disciplinary

Enforcement staff may provide the RDC with comments on the firm or individual's written representations. Any substantive communications between enforcement staff and the RDC (whether oral or written) are disclosable to the firm or individual.

A person may appoint a representative of his or her choice (who may be legally qualified) to attend the meeting at which oral representations will be made. The representative may make or assist in making the representations.

The RDC will specify a time as soon as is reasonably possible after receiving the notification for hearing the representations. The RDC will specify the place where it will hear the representations and may specify that the representations will be heard in private. The RDC may limit the time, length and content of any representations. The RDC may also ask the person or his or her representative at the meeting to clarify any issues arising out of the representations and may require the person and any representative to leave the meeting after making their representations.

It used to be the case that the FSA staff would meet in private with the RDC both before and after any oral representations. However, this practice was heavily criticised in the FSA's Enforcement Process Review 2005 and following the implementation of many of the Review's key recommendations, private meetings between FSA staff and the RDC no longer occur and, as a result, the process has become more transparent.

In all cases where the FSA decides not to take action following the issuance of a Warning Notice, it must issue a Notice of Discontinuance. The FSA can also issue a Public Statement about the proceedings being discontinued although the firm or individual should be careful to ensure that the FSA does not infer misconduct in its statement.

## Decision Notice

In the majority of cases, after consideration of any representations by the firm or FSA enforcement staff, the RDC assisted by its legal team, will issue a decision, which will be stated in a Decision Notice. The Decision Notice must give the FSA's reasons for its decision, and give notification of any right given by FSMA to have the matter referred to the Financial Services and Markets Tribunal ("Tribunal"). The Decision Notice will usually set out how the RDC dealt with the key points of the firm's representations. The issuance of the Decision Notice triggers further disclosure obligations on the FSA.

The FSA must not take any action specified in a Decision Notice during the period within which a reference may be made to the Tribunal. Nor may it take such action, if the matter is referred, until the matter, and any appeal against the Tribunal's decision, has been finally been determined.

## The Tribunal

A person who receives a Decision Notice (including a third party who has been given a copy of a Decision Notice) has the right to refer the FSA's decision to the Tribunal. The Tribunal is independent of the FSA and appointed by the Lord Chancellor's Department. The Tribunal is part of the Department for Constitutional Affairs and, overall, is the responsibility of the Lord Chancellor. It has a President, who is the judicial head; other judicial members, known as Chairmen, who must be legally qualified; lay members, who must have special experience in the financial sector; and a Secretary, who is responsible for administration.

Tribunal proceedings have all the trappings of court proceedings. The Tribunal's premises are based in London and contain courtrooms in which hearings are normally held. The Tribunal can sit anywhere in the United Kingdom, however, and will do so in appropriate cases. The Tribunal does not charge any fee for handling cases referred to it. As a general rule, public funding is not available for references to the Tribunal. However, where a matter relating to alleged market abuse is referred to the Tribunal, a special scheme of legal assistance has been established to provide financial help.

Any reference to the Tribunal must generally be made within 28 days of the date on which the Decision Notice was given. A reference to the Tribunal will be a full rehearing of the matter that gave rise to the challenged decision and the Tribunal may consider any evidence relating to the subject-matter of the reference, whether or not it was available to the FSA at the time the FSA took its decision.

As soon as both parties have had a proper opportunity to prepare their cases (with exchange of pleadings, documents and so forth) and are ready for a hearing, the Tribunal will arrange for it to be listed. Both parties will be consulted about their availability and that of their witnesses and representatives, but the Tribunal will expect all persons involved in the hearing to make themselves available within a reasonable timescale. The Tribunal has the power to compel attendance by means of a witness summons.

Hearings are normally held in public unless the Tribunal directs that it is necessary to conduct all or part of a hearing in private. If all the parties apply for the hearing to be in private, then the Tribunal may so direct, if the Tribunal is satisfied that doing so would not prejudice the interests of justice. If only one party applies for the hearing to be in private, then the Tribunal will direct to that effect if it is satisfied that a private hearing is necessary, having regard to the interests of morals, public order and national security, the protection of the private lives of the parties and any unfairness to the applicant or prejudice to the interests of consumers that might result from a hearing in public. The Tribunal must also be satisfied that a hearing in private would not prejudice the interests of justice.

On determining a reference, the Tribunal must remit the matter to the FSA with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination, and may make recommendations as to the FSA's regulatory provisions or its procedures.

## Costs

If the Tribunal finds wholly or partly in a firm's favour, that party may ask for its costs. FSMA provides that the Tribunal may order the FSA to pay the other party's costs if the Tribunal considers that the decision of the FSA that was the subject of the reference was unreasonable. Also, if the FSA acted vexatiously, frivolously or unreasonably in the course of the proceedings, the Tribunal may order the FSA to pay the whole or part of the firm's costs. Conversely, if the Tribunal considers that the firm acted vexatiously, frivolously or unreasonably, it may order the firm to pay the FSA the whole or part of its costs.

It is usually in very rare cases that costs against the FSA will be awarded by the Tribunal. Even where the FSA is unsuccessful in bringing its enforcement action against a person, the Tribunal will still be reluctant to award that person his costs. For instance, at a Tribunal hearing on 11 April 2006, Tim Baldwin successfully overturned the FSA's finding in its Decision Notice that he had committed market abuse but, despite this, the FSA was not required to pay his legal costs. The Tribunal held that, although there were elements of the FSA's investigation that could be characterised as "unreasonable", the process overall had not been and hence the Tribunal felt it was not empowered to make an award of costs against the FSA.

## Final Notice

The FSA must issue a Final Notice to a person to whom it has referred to the Tribunal, this may be the first time the public will be aware of proceedings against the firm or individual. Publication can only be withheld if it would be unfair or prejudicial.

## Right of Appeal on Point of Law

There is a right to appeal to the Court of Appeal or Court of Session on a point of law against a decision of the Tribunal. An appeal may be brought only with the permission of the Tribunal or the appeal court. If the appeal court considers that the decision is wrong in law, it may remit the matter back to the Tribunal for a rehearing and decision or make a decision itself. An appeal may be made from the Court of Appeal or Court of Session to the House of Lords with the leave of the Court or the House of Lords.

## Publicity

FSMA provides that neither the FSA nor any person to whom a Warning Notice or Decision Notice is given or copied may publish the notice or any details concerning it. FSMA also provides that, once a Final Notice has taken effect, the FSA must

publish such information about the matter to which the Final Notice relates as it considers appropriate, unless doing so would be unfair to the firm, or prejudicial to consumers. The FSA will therefore in almost every case issue a press release at the time of issuing a Final Notice. The press release will contain details about the reasons that justify the disciplinary action taken. While a firm may not be able to negotiate the precise content of the final FSA press release, the actual grounds that the FSA may seek to rely upon if disciplinary action is taken will be a subject of negotiation in any settlement or mediation discussions (see below).

If a matter is referred to the Tribunal, because the hearing is open to the public, the FSA, particularly in high-profile cases, can and does publish its position to the press and on its website during the course of the hearing.

## SETTLEMENT AND MEDIATION

### Introduction

A person who is or who may be subject to enforcement action may discuss the proposed action with FSA staff on a without-prejudice basis. Settlement discussions may take place on an informal basis at any time during the enforcement process. Where FSA staff have recommended that enforcement action be taken against a person, the mediation scheme will be available to the person where settlement discussions are, in the opinion of either party, unlikely to be successful.

The majority of enforcement cases settle before the issuance of a Warning Notice. The FSA has revealed that between October 2003 and July 2005, for example, around 80% of disciplinary cases that resulted in financial penalty were concluded by settlement. The FSA positively encourages settlement negotiation which runs in tandem with the formal notice based process.

Senior FSA staff or the FSA Executive or both have the necessary powers to agree any settlement. It used to be the case that the RDC had to approve any settlement between the firm/individual and FSA enforcement staff which led to criticism that the process was unfair and did not work efficiently. The RDC is no longer involved in settlement negotiations and settlement decisions are now made on behalf of the FSA by two decision makers of at least Director statement. The Director of Enforcement will usually be one of the decision makers, the second being designated as appropriate to the case.

For cases where investigations were appointed on or after 20 October 2005, there is a four stage discount procedure for early settlement. The amount of the penalty will first be negotiated and then a discount will be applied to the agreed amount depending on when settlement is reached, as follows:

- Stage 1 (early settlement phase) - 30% discount;
- Stage 2 (up to written representations) - 15% discount;

- Stage 3 (up to Decision Notice) - 5% discount;
- Stage 4 (following Decision Notice) - 0% discount.

If it is not possible to reach proposed settlement of the case by informal discussions, the person concerned may elect to submit the case to mediation. Mediation is likely to be concerned with reducing the level of financial penalty and reaching agreement about the content of any public statement rather than trying to persuade the FSA to change its mind.

## Mediation

Mediation is a confidential, voluntary, without prejudice dispute-resolution process in which a neutral mediator assists the parties in trying to settle their differences. The mediator is not a judge or arbitrator and has no power to bind the parties, but rather operates as a facilitator of the discussions.

Mediation will not be available in an enforcement case where the FSA is contemplating bringing a criminal prosecution. Mediation will be available in all other enforcement cases falling within the scope of the RDC. In those cases involving allegations of unfitness and impropriety based on judgments about dishonesty or lack of integrity and the exercise of the FSA's own initiative powers on a variation or cancellation of permission, mediation will be available subject to the FSA's consent.

Mediation will take place where an election to mediate is made after a Warning Notice has been issued and before the FSA issues a Decision Notice (the relevant Warning Notice under the terms of the scheme). Where an election to mediate is made before the issue of a Warning Notice or after the issue of a Decision Notice, mediation will be available subject to the FSA's consent. The firm or individual only has one chance to compel the FSA to mediate and cannot thereafter insist on it (unless the FSA permits).

As mediation will be on a without-prejudice basis, admissions made by the parties in the course of the mediation and documents prepared for the purposes of the mediation may not be referred to in subsequent proceedings relating to the dispute if the mediation is unsuccessful. However, if the mediation results in a proposed settlement of the dispute, the terms of the proposed settlement will form the basis of a Decision Notice, and subsequent Final Notice, or (where appropriate) Notice of Discontinuance, given by the FSA.

Following the issue of a Warning Notice, the person concerned will have access to certain material on which the FSA relied in deciding to commence disciplinary proceedings. The period following the issue of the Warning Notice is therefore a natural time for informal settlement discussions to take place in an attempt to resolve the matter. Mediation is intended to supplement those discussions where the parties consider that the involvement of a neutral mediator is required to facilitate progress.

Confidentiality is a key element to the mediation process. Matters disclosed in, and documents created for the purposes of, mediation cannot be referred to in the public domain and matters disclosed by one party to the mediator in confidence will not be disclosed to the other party without consent.

Under the mediation scheme, however, confidentiality will be limited to the extent that if any information indicating potentially criminal conduct is disclosed to the mediator, the mediator will not be required to keep the matter confidential (and may choose to terminate the mediation).

## Costs

The costs of the mediation provider in administering and conducting the mediation process (including the fee payable to the mediator) will be agreed between the FSA and the mediation provider when the mediation provider is appointed.

For each mediation the mediation provider will invoice the parties in advance for the anticipated costs of administering and conducting the mediation. The FSA and the firm will each bear half of these costs. Any additional costs incurred by the mediation provider will be invoiced after the mediation. These costs will also be shared. The costs referred to above do not include legal or other costs that the FSA or firm may incur in relation to the mediation, which will be the responsibility of the incurring party.

## Advisers

The parties may bring legal or other advisers of their choice with them to the mediation, although it is important to preserve the non-legalistic, pragmatic character of the mediation process.

## CONCLUSION

The approach of the FSA to enforcement proceedings is evolving. The increased readiness of the FSA to commence enforcement proceedings and the substantial increase in financial penalties imposed inevitably lead to a more adversarial approach.

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