of the level 1 measures. These are adopted and implemented in the form of Regulations;

- level 3 measures – these are guidance and recommendations on technical issues arising from the level 1 and level 2 measures. Strictly speaking they are not binding on Member States but an inconsistent approach taken by a Member State or its competent authorities could indicate a breach of EU law.

1.53 All three may have an impact on regulation in the UK whether as a measure directly applicable to firms and individuals conducting business in the UK, by requiring the UK to implement its own legislation or by standards or guidance that indicates how EU measures should be interpreted.

1.54 The effect of the substantial financial services reform agenda from the EU is further concentration of lawmaking at the EU level, reinforced by the creation of the European System of Financial Supervision (ESFS) and the European Supervisory Authorities (ESAs) who are responsible for level 2 measures, leaving little room to manoeuvre for differing national implementation. The European Commission (the Commission) has tended to introduce financial services legislation in the form of Regulations because they have a more harmonising effect than Directives, which require national transposition, whereas Regulations are directly applicable and require no transposition time to implement into the legislation of Member States.

1.55 The role of the EU in primary and secondary legislation in the financial services space is increasing. Member States play a role in the development and negotiation of EU legislation through representation in the Council and Member State's regulators (known as competent authorities in the EU) are represented in the European Supervisory Authorities (ESAs).

The European System of Financial Supervision (ESFS)

1.56 In 2010, in response to the financial crisis which exposed important failures in financial supervision, the EU established the ESFS, composed of three sectoral ESAs, working with an overarching body and the national competent authorities:

Sectoral ESAs

- The European Banking Authority (EBA)
- The European Insurance and Occupational Pensions Authority (EIOPA)
- The European Securities and Markets Authority (ESMA)

Oversight body

- The European Systemic Risk Board (ESRB)

Competent authorities

- the competent authorities (ie national regulators in the Member States)

The ESAs were established to:

- improve the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision;
- protect depositors, investors, policyholders, consumers and other beneficiaries;
- ensure the integrity, efficiency and orderly functioning of financial markets;
- safeguard the stability of the financial system; and
- strengthen international supervisory co-ordination.

1.57 In order to meet these objectives, each ESA is required to contribute to ensuring the coherent, efficient and effective application of relevant EU law.

1.58 The ESRB is intended to be an EU body with macro-prudential oversight. Its role is to contribute to the prevention and mitigation of systemic risks to the EU's financial stability by means of ex-ante warnings and recommendations.

The example of ESMA

1.59 The EBA, EIOPA and ESMA have similar powers set out in EU legislation and we consider the legislative provisions relating to ESMA by way of example. ESMA's powers are outlined in Regulation 1095/2010[1]. The types of powers can be divided into three categories: direct supervision; decision making/regulatory powers; and decision making which overrides national competent authorities' decisions.

1 Regulation 1095/2010 ([2010] OJ L331/84) on establishing a European Supervisory Authority (European Securities and Markets Authority).

1.60 The direct supervisory powers of ESMA relate to credit rating agencies, trade repositories' data[1], identifying and managing systemic risks[2], undertaking peer reviews of competent national authorities[3], recommending action to the Commission when a competent authority has breached EU law[4] and co-ordinating the college of supervisors[5].

1 Regulation 648/2012 ([2012] OJ L201/1) on OTC derivatives, central counterparties and trade repositories, Article 73.
2 Regulation 1095/2010, Articles 22(1)(b) and 23.
3 Regulation 1095/2010, Articles 8(1)(e) and 30.
4 Regulation 1095/2010, Article 17.
5 Regulation 1095/2010, Articles 8(1)(i) and 21.

1.61 ESMA develops guidelines and recommendations[1] and drafts the regulatory technical standards (delegated acts)[2] and implementing technical standards (implementing acts)[3] that supplement the level 1 measures.

1 Regulation 1095/2010, Articles 8(1)(a), 8(2)(c) and 16.
2 Regulation 1095/2010, Articles 8(1)(a), 8(2)(a) and 10.
3 Regulation 1095/2010, Articles 8(1)(a), 8(2)(b) and 15.

approval and obligations of senior managers at banks and other deposit takers, and strengthening sanctioning powers for serious failures in those roles.

2.53 The FS(BR)A 2013 amends the regulatory framework set out in the FSMA 2000 to implement these recommendations, although supplementary Handbook changes in relation to approval and conduct of individuals working in the financial services sector are left to consultation and rule-making by the Regulators. The commencement date for the relevant legislative provisions has not, at the time of writing, been announced. Until the commencement date, the approved person regime, as described above, will apply to individuals holding 'controlled functions' at all firms. In addition to the date when the legislation comes into force, there are other uncertainties as to which individuals at which firms will be affected and the extent of the changes to the Regulators' rules governing standards of conduct. The legislative changes primarily relate to individuals working at UK-incorporated dual-regulated deposit takers and investment firms (collectively referred to as banking firms in this book), but not insurers. The relevant changes include:

- for senior managers of banking firms, the existing approved persons regime will be replaced with a 'senior persons' regime. Banking firms will need to obtain approval for 'senior persons'. A 'senior person' is a person carrying out a designated senior management function with responsibility for (or taking or participating in decisions concerning) an aspect of a banking firm's affairs that involves, or might involve, a risk of serious consequences for the banking firm, or for business or for other interests in the UK. Although a wide range of individuals could be categorised as senior persons, the Regulators are likely to designate only the most senior positions, or positions with a key influence on the soundness of a banking firm, as senior management functions;
- other more junior employees of banking firms, who would broadly have fallen within the approved persons regime, will be vetted and certified annually by the banking firm itself as fit and proper to hold that position;
- a relevant banking firm seeking approval for a senior manager has a statutory responsibility to vet that person's qualifications, training, competence and personal characteristics to satisfy itself that the person is suitable for the role[1]. The approval application for these persons will have to be accompanied by a written statement of their responsibilities[2] and, when they cease to perform their role, they will have to prepare a handover certificate stating how they have fulfilled those responsibilities. Regulatory approval for them to act as senior managers may be time-limited or subject to conditions[3];
- following a successful enforcement action against a banking firm for serious failings, the Regulators will be able to exercise disciplinary powers, broadly speaking, against senior persons responsible for the relevant functions at the time, unless those persons can show that they took reasonable steps to prevent the failings[4]. The important point is that the burden of proof is reversed. Other heads of misconduct for which approved persons can face disciplinary action are extended to all employees at these firms;

- the existing Principles and Code for approved persons will be replaced with a new set of rules to apply to the conduct of senior persons and other employees at banking firms. The Regulators may decide to change the approved persons regime so that these new standards and requirements also apply to approved persons at firms other than banking firms;
- the time limit for the Regulators to take disciplinary action against individuals will be increased to six years (from three years)[5];
- a senior person at a banking firm (except credit unions) will also be potentially liable for a new criminal offence of reckless misconduct in the management of a bank if, broadly speaking, a decision which they make causes the institution for which they work to fail and their conduct is viewed as falling far below what is reasonably expected of a person in their position[6].

1 FS(BR)A 2013, s 21.
2 FS(BR)A 2013, s 20.
3 FS(BR)A 2013, s 23.
4 FSMA 2000, s 66A(5) and (6) and s 66B(5) and (6), as inserted by the FS(BR)A 2013, s 32(2).
5 FSMA 2000, s 66, as amended by the FS(BR)A 2013, s 28.
6 FS(BR)A 2013, s 36.

2.54 The Regulators will consult on implementation of the new regulatory regime for senior persons in 2014, with a view to introducing the senior persons regime in 2015. At the same time, the Regulators intend to consider the implications of these changes for the approved persons regime more generally.

THE REGULATORY TOOLKIT

2.55 What powers do the Regulators have to promote or enforce compliance with the obligations placed on firms and individuals? Enforcement and discipline are not the Regulators' only means of achieving their regulatory objectives. The FSMA 2000 and the Handbooks give the Regulators a broad range of powers and functions to enable them to do so. The Regulators refer to these as their 'regulatory toolkit'. Understanding briefly what these tools are helps to place the enforcement and disciplinary regime into perspective. As part of this, it is helpful to look briefly at the Regulators' general approach to supervision.

2.56 The Regulators' tools are wide-ranging in their nature and effect. Some allow the Regulators to influence the industry as a whole[1]; others are designed to influence the behaviour of consumers in general[2]. The protection of consumers is a recurrent theme as well as one of the FCA's prescribed operational objectives. Five of the eleven Principles for Businesses relate specifically to how firms deal with their clients[3]. Another important part of the regime is the publicly available Register, which the FCA is required to keep[4], of those who are, broadly, authorised, approved[5] or recognised under the FSMA 2000, and those against whom a prohibition order has been made. Consumers and others should therefore readily be able to ascertain whether they are dealing with someone who is entitled to carry on regulated activities.

but also others who may have been involved less directly or may have relevant evidence, for example back office staff or a person to whom an employee under suspicion reported. The firm may wish to ensure at an early stage that it has identified all the relevant people, so that it is in a position to assess whether or not their conduct should be reviewed and whether or not they are likely to have relevant documents or other evidence. Steps can also then be taken, for example, to obtain evidence or secure their future co-operation, if any of those people is likely to be unavailable to the firm in the future for any reason. Given the FCA's focus on the responsibility of senior management for a firm's regulatory failings[1], it is important that the firm's list of relevant people includes all those in the supervisory chain for the employee concerned including the SIF[2] responsible for the relevant business area.

1 See para **1.34**.
2 Significant Influence Function, see para **1.77**.

3.24 In some cases, it may be appropriate, whilst the firm reviews the activities of the relevant employees, to take immediate action to suspend suspect-employees or remove them from sensitive positions[1]. This is a matter of common sense, particularly where the circumstances suggest that the breach may result from some deliberate action by an employee. But it may also be viewed by the Regulators as a positive step taken by the firm in response to the breach, in order to protect its customers, to ensure that the breach is not repeated in the short term and protect the evidence.

1 In so far as it takes any disciplinary action, the firm should ensure that it complies with the terms of any disciplinary procedure in conjunction with the guidance contained in the ACAS Code of Practice 1 – Disciplinary and Grievance Procedures (April 2009). This should reduce the risk of a dismissed employee successfully claiming that he has been unfairly dismissed or, in the event that the claim is successful, reduce the risk of a Tribunal finding an employer to have unreasonably failed to follow the Code and increasing the award by up to 25%.

3.25 Three issues are worth further consideration:

(1) whether or not material relating to employees recorded in the ordinary course of the firm's business has been lawfully recorded;

(2) whether or not adequate arrangements are in place that allow the firm to review that material once a problem comes to light;

(3) the extent to which a more intrusive investigation can be made into a particular individual after a problem comes to light.

The first two issues will be discussed together, and some practical guidance provided, and then the third issue will be considered. The same English legal issues[1] arise in relation to all three questions, but the importance of the legal issue differs according to the question.

1 Certain legal obligations may apply throughout the EU although they may be implemented differently in each country. For example, the Data Protection Act 1998 was intended to implement the EU Data Protection Directive (95/46/EC). Note that the draft European General Data Protection Regulation (which will supersede this Directive) was unveiled on 25 January 2012. At the time of writing the Regulation was going through the first reading stage at the European Parliament. The European Parliament, the European Council and the European Commission would like to see the Regulation adopted before the European Parliament elections and the

next rotation of the Commissioners in 2014. If this happens in the intended time frame, the Regulation is likely to become directly applicable in Member States in 2016. However the privacy laws of other EU states do not necessarily reflect the provisions of the 1998 Act. This issue could be relevant if, for example, a telephone call was taped at an overseas branch of the firm. How the firm acts where it is required under the UK legislation to provide information to the Regulators when asked to do so, but is constrained by applicable overseas law from doing so, is a particularly difficult problem in practice. See further para **5.69** below. There may also be applicable overseas legal considerations, for example data protection legislation applies throughout the EU and in some other countries and many other states have their own privacy laws.

Material recorded in the ordinary course of business

3.26 Firms regularly monitor and store e-mails and tapes of telephone conversations and indeed often do so under regulatory obligations. But the interception and recording of communications, including both e-mails and telephone calls, by the firm, even within its own private telecommunications system, may have other legal implications. In particular, firms need to have in mind the Data Protection Act 1998[1], the Regulation of Investigatory Powers Act 2000[2] and the employee's possible right under the Human Rights Act 1998 to respect for privacy in connection with family life and correspondence[3]. The firm's ability not only to record the material, but also to review the material recorded may be restricted[4].

1 Recording, reviewing and using tapes of telephone calls, CCTV and e-mails relating to employees, among other things, may amount to the processing of personal data about a data subject (ie, the employee) under the Data Protection Act 1998, in which case the firm, as a data controller, must comply with the eight Data Protection Principles and the other provisions of the Data Protection Act 1998. In the current context, the firm will be concerned to ensure data is acquired and stored fairly and lawfully. It will also be necessary to consider whether the data subject must be informed about the firm's activities, or whether exemptions under the Act may be relied upon. Failure to comply with the requirements under the 1998 Act may give rise to enforcement action by the Information Commissioner (including the issue of a monetary penalty notice of up to £500,000 for a serious contravention of the Data Protection Act and the instigation of criminal proceedings) or a claim for damages by the employee. For a more detailed discussion, see Jay, *Data Protection: Law and Practice* (4th edn, 2012).
2 The Regulation of Investigatory Powers Act 2000, s 1(3) prohibits the interception of communications on a private telecommunications system and makes it actionable at the suit of the sender, recipient or intended recipient. But interceptions are permitted if they fall within the Telecommunications (Lawful Business Practice) (Interception of Communications) Regulations 2000, SI 2000/2699: see para **3.27**, n 2 below.
3 The right to respect for privacy, and the question whether the employee has such a right against the firm is discussed at para **3.29** ff below.
4 Most of these hurdles can be overcome if the employee has consented to the monitoring operation. 'Consent' is defined for these purposes in the Data Protection Directive (95/46/EC).

3.27 The firm therefore needs to have appropriate arrangements in place to ensure that the recording and review of material does not contravene the applicable requirements. In broad terms, those arrangements need to include:

- an understanding on the part of employees that their e-mails and telephone calls are monitored, stored and reviewed for various purposes, including to ascertain regulatory compliance, and, preferably, their consent to this;
- a clear and internally available policy on the use of e-mails, the telephone[1]

1 FSMA 2000, s 398(1) and see para **5.79** ff below.
2 This would also probably be a breach of the Regulators' rules: see para **3.83** ff above.

Obligations to report to other bodies

3.90 In some situations, the firm may be under an obligation to report a matter to bodies other than the Regulators. This could arise either in relation to the firm's own conduct or in relation to the conduct of others (for example, its employees) of which it is aware.

Reporting the firm's conduct to other bodies

3.91 As outlined at paras **3.65** ff and **3.67** ff above, the Regulators regard both firms and approved persons as under an obligation to be open and co-operative with any other applicable regulators, for example stock exchanges or overseas regulators. Moreover, it is obviously possible for conduct which gives rise to a regulatory issue in the UK also to raise regulatory concerns in other jurisdictions in which the firm does business or vice versa[1]. There may indeed be reporting obligations in those other jurisdictions in those circumstances. From a practical perspective, if the firm concludes that it has obligations to report to another regulator, it needs to bear in mind that regulators are increasingly communicating with one another (as explained in **CHAPTER 7**). It will therefore need to take care to avoid a situation where something it should have reported to one regulator is reported to that regulator by another regulator. In the majority of circumstances it should provide the same information to each relevant regulator[2].

1 See, for example, the note to para **3.66** above.
2 In some circumstances, however, this may not be appropriate such as where the degree of protection applying to the disclosure that will be provided by the other regulator may render the disclosure unnecessarily discloseable to third parties in any likely or concurrent civil litigation. What civil litigation may arise at the same time as a regulatory problem is considered at **CHAPTER 19** below.

Reporting the conduct of others

3.92 Whilst there is no general whistleblowing obligation under English law, there are certain well-known exceptions, for example in relation to money laundering and terrorism[1]. As explained at para **3.66** above, the firm may owe obligations to report the conduct of other persons to other regulators in the UK or other jurisdictions.

1 See para **3.93** ff below.

3.93 Under the Proceeds of Crime Act 2002 (POCA 2002), those working in the 'regulated sector'[1] (which includes all firms) are obliged to report any knowledge or suspicion of money laundering to the authorities[2]. The obligation to report money laundering is onerous, and covers the laundering of proceeds generated from any criminal act, no matter how small the sums involved, how minor the crime or when it took place[3]. Therefore, firms and their employees

may find themselves in a position where they are required to report their clients, other parties or even themselves, to the authorities or otherwise risk committing an offence. Additionally, an objective or 'negligence' test in the legislation ensures that those in the regulated sector act proficiently when dealing with potentially reportable matters. Simply failing to report where there are reasonable grounds for knowing or suspecting money laundering is an offence, even if the person concerned genuinely had no suspicion of money laundering. Firms therefore tend to opt to report in many situations rather than risk committing any of the offences even if there is little value to the authorities.

1 See the POCA 2002, Sch 9.
2 The Serious Organised Crime Agency in the UK. In addition, to the obligation to report and offence for failing to do so, the breadth of the offences under the POCA 2002 can mean that firms are also at risk of committing money laundering in certain situations, see the POCA 2002, ss 327–329.
3 This applies retrospectively, such that the practices of a client that were non-compliant some years ago may be reportable.

3.94 There is a substantial body of terrorism legislation in the UK[1] which mirrors many of the obligations in the general money laundering regime in respect of funds and property for use by terrorists, as well as the proceeds of terrorist activities. Firms are required to report suspicions or knowledge of terrorist funding to the authorities. However, it is generally much more difficult for firms to identify terrorist funds or proceeds. Whilst more typical money laundering aims to cleanse proceeds with a criminal origin, terrorist finance instead employs funds from many different and legitimate sources, for criminal or terrorist ends. The breadth of the legislation[2] also means that the activities of groups not conventionally associated with terrorism, such as various political interest groups, may be caught which increases the burden on firms when monitoring accounts.

1 See the Terrorism Act 2000; Terrorism Act 2006; Counter-Terrorism Act 2008; Terrorist Asset-Freezing etc Act 2010; Terrorism Prevention and Investigation Measures Act 2011; Al-Qaida (Asset-Freezing) Regulations 2011, SI 2011/2742; Al-Qaida (United Nations Measures) (Overseas Territories) Order 2012, SI 2012/1757; and Afghanistan (United Nations Measures) (Over-seas Territories) Order 2012, SI 2012/1758.
2 Terrorism Act 2000, s 1 (as amended by the Terrorism Act 2006, s 34) sets out the definition of terrorism.

HOW TO NOTIFY THE REGULATORS

Making notifications under specific rules

3.95 Notifications to the Regulators are required[1] to be in writing, in English, and to give the firm's Firm Reference Number, unless the notification rule states otherwise or the notification relates solely to Principle 11 and not to one of the specific rules. Details of how to make the notification are found in the Handbooks at SUP 15.7.4R–15.7.9G. Notifications can be made by post, hand delivery, fax, e-mail, or online submission via the FCA's or PRA's website[2]. A notification not made in compliance with the rules is considered invalid and the firm may therefore be in breach of the notification requirement[3].

investigation. Where the FCA relies upon Principle 11, there may be little option but to co-operate and the maintenance of a close mutual relationship with the FCA may be the most effective way for the firm to have some control over the process. Co-operating with the FCA in an investigation may also be of benefit to the firm if a question later arises of whether (and what) enforcement action should be taken following the investigation, as credit may be given to the firm for its co-operation[1].

1 The FCA has indicated that it will be inclined to give credit to firms and individuals who assist the FCA in conducting its enquiries quickly and efficiently. The FCA will consider each case on its merits and there are no hard and fast rules as to when credit is given; however, there are instances where the FCA has not taken enforcement action in respect of an issue as a result of the firm's or individual's response to the issue: see the section of the FCA's website (www.fca.org.uk) entitled 'The benefits to firms and individuals of cooperating with the FCA'. See further paras **4.55** ff and **8.22** ff below.

4.28 Under Principle 11, a firm is required to deal with the FCA in an open and co-operative manner and must disclose to the FCA appropriately anything relating to the firm of which the FCA would reasonably expect notice[1].

1 The equivalent provision for individuals is set out at Statement of Principle 4 of the Code of Practice for Approved Persons: see the Handbooks at APER 2.1A.3 and para 2.46 ff above. Note that both Principle 11 and Statement of Principle 4 apply in respect of both the FCA and PRA.

4.29 This has two limbs. First, the need to deal with the FCA in an open and co-operative manner; and, second, the requirement to give the FCA notice of matters that arise. The first of these limbs is considered here. The scope of a firm's obligations under the second limb is discussed at para **3.44** ff above.

4.30 The FCA has provided detailed guidance on the co-operation that it expects from firms under Principle 11. Although this guidance appears in the Supervision section of the FCA Handbook[1] and is phrased primarily in the language of supervision, as has been seen, many regulatory issues may be dealt with in that context and, in addition, it applies in the enforcement context as well[2]. Broadly, the FCA expects to rely upon Principle 11 in order to obtain the information that it needs from firms in many situations (although not generally when it is conducting a formal investigation). The FCA considers that Principle 11 sets out the basic degree of co-operation that firms should provide and has attempted to demonstrate to firms the benefits of compliance[3].

1 See the Handbooks at SUP 2.3.
2 See the FCA Enforcement Guide at EG 2.3 and 2.4 and the Handbooks at SUP 2.1.8.
3 See the section of the FCA's website (www.fca.org.uk) entitled 'The benefits to firms and individuals of cooperating with the FCA'. The equivalent provision for individuals is set out at Statement of Principle 4 of the Code of Practice for Approved Persons: see the FCA Handbook at APER 2.1A.3 and see also para **4.47** below.

What information and co-operation can a firm be required to provide?

4.31 The FCA Handbook states that, in complying with Principle 11, the FCA considers that a firm should[1]:

- make itself readily available for meetings with the FCA;
- give the FCA reasonable access to any records, files, tapes or computer systems which are within the firm's possession or control[2] and provide any facilities which the FCA may reasonably request;
- produce to the FCA specified documents, files, tapes, computer data or other material in the firm's possession or control as reasonably requested;
- print information in the firm's possession or control which is held on computer or on microfilm or otherwise convert it into a readily legible document or other record which the FCA may reasonably request;
- permit the FCA to copy documents or other materials on the firm's premises at the firm's reasonable expense and remove such copies and hold them elsewhere or provide any copies as reasonably requested; and
- answer truthfully, fully and promptly all reasonable questions which are put to it by the FCA.

1 See the Handbooks at SUP 2.3.3. Note that the FCA may also make such requests in order to assist other regulators and may pass on information to those other regulators without having notified the firm: see the Handbooks at SUP 2.3.11 and para **5.34** ff below in respect of overseas regulators.
2 Such material may, of course, relate to the firm's customers, employees or market counterparties.

4.32 It should also take reasonable steps to ensure that its employees, agents and appointed representatives, and any other members of its group and their employees and agents, provide the same assistance[1].

1 See the Handbooks at SUP 2.3.4.

4.33 This is subject to the statutory limitations on the documents the FCA can require firms to produce, in particular, documents falling within the statutory test for legal privilege[1]. The FCA has also indicated that it would not normally use Principle 11 to seek information protected by the (rather limited) statutory protection for banking confidentiality in circumstances where this statutory protection would prevent the FCA obtaining the information using its formal powers[2].

1 FSMA 2000, s 413 and see the Handbooks at SUP 2.2.3 and the discussion at para **5.56** below.
2 See the Handbooks at SUP 2.2.3 and see also para **5.60** ff below.

4.34 The FCA can also conduct an investigation by carrying out 'mystery shopping' in relation to a firm, its agents or appointed representatives, approaching them in the role of a potential retail customer, and can record any telephone calls or meetings held. It can do this to establish a firm's normal practices in a way which would not be possible by other means[1].

1 See the Handbooks at SUP 2.4 and see also para **13.26** below. Note that this power is not exercisable by the PRA.

to disseminate information in certain situations, for example to other regulators. It is possible that a court could take the view that the provision of information to the FCA sufficiently impacts on its confidentiality to destroy any privilege. Indeed, the expectation that the information would be disclosed by the regulator was one of the points considered by Arden J to indicate the lack of public interest immunity in *Kaufmann*.

4.162 Sixth, even if the material does remain privileged as against third parties notwithstanding its disclosure to the FCA, the FCA will generally speaking (see para **4.226** ff below) be able to use it in Tribunal or certain court proceedings[1]. If the Tribunal or court hearing is held in public as is likely to be the case, then the information is no longer likely to be confidential and, as a result, privilege will be lost and so the material will not be protected from disclosure[2].

1 The ability to refer in Tribunal or court proceedings to documents that are otherwise protected could also, in certain circumstances, allow the FCA to bypass the statutory confidentiality restrictions outlined at para **4.226** ff below.
2 Publicity during the court process is considered at para **19.12** below. The same question is considered in relation to Tribunal hearings at para **12.37** below.

Types of material that can cause particular difficulty

Communications with or from compliance officers

4.163 Compliance staff are often involved when regulatory problems arise and indeed this is usually part of their normal role. However, the production of documents by compliance officers can cause a number of problems. First, it is important to understand from the outset that documents created by compliance staff in the course of their routine compliance function, even if such staff are legally qualified, are unlikely to be legally privileged[1].

1 But if a legally qualified compliance officer produces a document, the purpose of which is to give legal advice to the firm, then that document may be legally privileged.

4.164 Second, if the compliance department investigates the matter once the problem comes to light, it is likely that neither the documents which they produce in the context of their investigation, for example notes of interviews with other staff, nor their report, will be legally privileged[1]. Such reports and documents can in practice be particularly damaging[2]. If the reason, or one of the reasons[3], for having the compliance department investigate and produce a report is to enable the firm to address the compliance issues arising from the problem, then the investigation is unlikely to be privileged and, as a result, it is unlikely that any material produced will be protected from disclosure. This applies even more so if the purpose of the investigation is to assess the commercial implications of the matter.

1 Subject to the same exception articulated above.
2 See the discussion at para **4.116** above.
3 See *Waugh v British Railways Board [1980] AC 521, HL* in which an accident report was held to have been produced not only in anticipation of litigation but also for the purpose of railway operation and safety. This was held as insufficient for a claim to privilege.

4.165 In order to be privileged, the document must be produced either in response to a request from a legal advisor to enable him to provide legal advice[1]

or in relation to existing or contemplated litigation. In either case, there will be issues as to whether the particular document does fall within the scope of, as applicable, legal advice privilege or litigation privilege and the answer will depend very much upon the circumstances. As a practical matter it may assist if it was demonstrable on the face of the report that it was produced for the requisite purpose[2]. Generally, it may assist that a lawyer was instructed before the report was prepared and was involved in determining its parameters and that the report is addressed to him and not to the firm.

1 Such legal advice could be requested from an external or internal lawyer. It could also include legal advice from a compliance officer who is legally qualified provided that the provision of such advice is the main purpose of the investigation. In practice it may be difficult to demonstrate that the purpose of the investigation is to enable the compliance officer to provide legal advice to the firm. Generally, care must be exercised in relying upon legal advice privilege: see *Price Waterhouse v BCCI Holdings (Luxembourg) SA [1992] BCLC 583*. Care must also be taken to ensure that the advice is requested by the 'client': see para **4.155** above.
2 This will not, though, be conclusive: see *Waugh v British Railways Board [1980] AC 521, HL*. Nonetheless, it may be helpful to mark documents 'legally privileged – created to obtain legal advice and for legal proceedings', where appropriate.

Communications between the firm and its employees

4.166 The firm's communications with its employees may also cause difficulties. The decision by the Court of Appeal in the BCCI[1] litigation means that legal advice privilege[2] can only apply to communications between lawyers and those employees within the firm who can be said to be their 'client'[3]. Who will be considered to be the 'client' is uncertain[4]. In practice, this has a significant effect on a firm's ability to collect information from its employees (for example, by interviewing them and making notes of interviews) in a way that is protected from disclosure. Where feasible, it may be advisable to establish in advance who exactly constitutes the client. This ought to be done early on in the process so that those handling the investigation know the scope of the protection from disclosure. It will also be appropriate to consider internal processes for the gathering of information and for the creation of preparatory documents in relation to the investigation so that they will not be disclosable in subsequent litigation.

1 See *Three Rivers District Council v Governor and Company of the Bank of England (No 5) [2003] EWCA Civ 474*.
2 At the investigation stage, 'litigation privilege' is unlikely to apply: see para **4.153** ff above.
3 It is uncertain whether and, if so, how this decision will apply to the 'protected items' regime under the FSMA 2000: see para **5.56** ff below.
4 In *Three Rivers District Council v Governor and Company of the Bank of England (No 5) [2003] EWCA Civ 474*, the Court of Appeal gave no guidelines as to how to decide whether an employee of the firm is the client. See para **4.133**.

4.167 Where communications are held to be privileged, the privilege will be that of the firm and not of the employee[1]. Accordingly it will only be for the firm to decide whether to waive the privilege and disclose the communication, for example, to the FCA. Even if the information may be damaging to the employee, he will be likely to have no general right to prevent its disclosure[2]. The employee, for his part, will be likely to be bound by a duty of confidentiality that may prevent

2 The requirement for material to be 'necessary' or 'expedient' will give a margin of discretion to the investigator: see Lord Diplock in *Secretary of State for Defence v Guardian Newspapers Ltd [1985] AC 339, [1984] 3 All ER 601*. Precisely what will be 'necessary' will depend upon the circumstances. It will 'lie somewhere between "indispensable" on the one hand and "useful" or "expedient" on the other': see Lord Griffiths in *Re an Inquiry under the Company Securities (Insider Dealing) Act 1985 [1988] AC 660, [1988] 1 All ER 203*.

FSMA 2000, s 168(2) – investigations into certain serious criminal or regulatory offences

When can an investigation be commenced?

5.27 The Regulators may appoint an investigator under the FSMA 2000, s 168(2) to conduct an investigation on its behalf if it appears to it that there are circumstances suggesting that any of the following offences may have been committed[1]:

- a person has falsely described or held himself out to be authorised or exempt in relation to a regulated activity[2];
- a person gives a false or misleading statement or creates a false or misleading impression[3];
- the criminal offences of insider dealing[4];
- a breach of the general prohibition[5];
- a contravention of the restrictions on financial promotion[6]; or
- any market abuse[7].

1 As noted above, this power may also be exercised by the Secretary of State.
2 FSMA 2000, s 24(1).
3 Financial Services Act 2012, Pt 7.
4 Under the Criminal Justice Act 1993, Pt V.
5 The criminal offence of breaching the general prohibition against carrying on regulated activities without being authorised or exempt: see the FSMA 2000, ss 19 and 23.
6 FSMA 2000, ss 21 and 238.
7 FSMA 2000, Pt 8.

5.28 This is the most serious of the investigation procedures. In contrast with the other forms of investigation, the subject of an investigation under the FSMA 2000, s 168(2) will not generally be notified of the investigation, at least in the first instance[1]. Furthermore, an investigator appointed under s 168(2) has the widest powers to obtain information from the widest range of people.

1 FSMA 2000, s 170(3). See also the FCA Enforcement Guide at EG 4.3.

When will the power be exercised?

5.29 Leaving aside market abuse and insider dealing, which are discussed separately in **Chapter 17**, investigations under the FSMA 2000, s 168(2) are

primarily aimed at situations where people are carrying out unauthorised business in some way. The main aim in exercising s 168(2) powers in such circumstances is to protect the interests of consumers[1]. The Regulators will therefore need to consider at an early stage whether it should take urgent enforcement action, as well as continuing its fact finding investigation.

1 FCA Enforcement Guide at EG 2.13 (and EG 2.12–2.14 generally).

What information can the firm be required to provide?

5.30 In outline[1], an investigator appointed under the FSMA 2000, s 168(2) may require any person whom he considers is, or may be, able to give information which is, or may be, relevant to the investigation[2] to:

- meet with an investigator and answer questions or otherwise provide such information as the investigator may require for the purposes of the investigation;
- produce specified documents, or documents of a specified description which appear to the investigator to relate to any matter relevant to the investigation; or
- give the investigator all assistance in connection with the investigation which the person is reasonably able to give.

1 This topic is dealt with more fully in **Chapter 4** in relation to the Regulators' information gathering powers.
2 FSMA 2000, s 173.

5.31 The powers afforded by the provision are different from those that apply to the FSMA 2000, ss 167 and 168(1) and (4) investigations, primarily because the s 168(2) powers are expressed not by reference to the person under investigation, but instead by reference to those persons who may hold relevant information. The rationale is that, in an investigation of this nature, it may not be clear (at least at the outset) who will be the person under investigation. Rather, it may be that the investigation relates to a general situation.

5.32 At its widest, a person whom an investigator considers 'may be able' to give information which 'may be relevant to the investigation' could be required to give 'all assistance' with the investigation. This is a very low hurdle for an investigator and gives him broad discretion as to what assistance he can require.

5.33 There are, however, some limitations. An investigator can only require reasonable assistance, which means that he cannot place unreasonable demands on people, whether as to the time they are to expend or as to the expense that they must incur in preparation for the questions or in any other respect[1]. Also if, for whatever reason, the person concerned does not have legal representation, then that is a factor to be taken into account in determining what is reasonable[2].

1 See *Re Mirror Group plc [1999] 3 WLR 583, at 601*.
2 See *Re Mirror Group plc [1999] 3 WLR 583, at 604*.

transfer. Determining whether a transfer will definitely be caught by this exclusion is not therefore straightforward. It is not advisable for a firm to rely on this exclusion without (at the very least) legal advice to that effect or, in the majority of cases, a court judgment confirming that the transfer is indeed necessary. Given that obtaining a court judgment is an expensive and time consuming exercise, in many circumstances it is advisable to seek to rely on an alternative exception.

Necessary in connection with legal proceedings

7.134 There are exemptions on transfers that are necessary for: (a) the purpose of or in connection with legal proceedings; and (b) for the purpose of obtaining legal advice. These exceptions are unlikely to be of assistance in practice in these circumstances as regulatory investigations are not 'legal proceedings' as envisaged by the DPA 1998. In addition, although an entity may be able to provide documents to its legal advisers for the purposes of seeking advice in connection with a regulatory investigation, this will not enable documents to be provided to the regulator.

Transfers via UK regulators

7.135 The exemptions set out above are therefore unlikely to be particularly satisfactory as a means for transferring data to a non-EEA regulator. Therefore, in this scenario, it is advisable to encourage the foreign regulator to liaise with its UK counterpart and, if possible, ask the UK counterpart to issue a request for the documents and/or information sought by the foreign regulator. The UK data controller then has a legal compulsion to provide documents to its UK regulator who can then, providing there is an MoU in place between the two countries, share documents with the foreign regulator.

7.136 Providing documents through the FCA is fast becoming the best practice approach for UK data controllers required to provide documents to foreign regulators in jurisdictions without sufficient data protection safeguards. The steps to be taken in such circumstances will vary on a case-by-case basis and will in large part depend on the familiarity of the foreign regulator with this process. It is important to identify whether an MoU exists between the two countries pursuant to which the documents can be passed between regulators. If an MoU is in place a firm should then contact the FCA to advise it that the entity will be asking the foreign regulator to request documents through the FCA to avoid a potential breach of the DPA 1998. The FCA is relatively familiar with these requests, however the foreign regulator may not be familiar with this process and so may require some persuasion to adopt this approach. In these situations, it is often helpful to have some form of legal opinion confirming the likelihood of a potential breach of the DPA 1998 unless documents are obtained through the FCA which can be shared with the foreign regulator. It will also be crucial to work closely with local counsel who can leverage relationships with the local regulator to help facilitate the process.

New EU Data Protection Regulation

7.137 A new EU-wide Data Protection Regulation has been proposed which will be directly effective in member states and replace the Directive (and hence also the implementing legislation in individual member states such as the DPA 1998). The full text of the new Regulation has (at the time of printing) not yet been finalised and is not expected to come into force until 2015. The new Regulation is intended to be broader than existing legislation and will expressly apply to data controllers headquartered outside Europe. The draft Regulation also contains an even broader definition of 'personal data' and regulators will have new powers to impose large fines for breaches of up to 2 per cent of global turnover. There are also express provisions to make international data transfers easier, such as the increased recognition of binding corporate rules and the use of EU Model International Data Transfer Agreements. Until the final text of the Regulation is published the full implications remain uncertain. The provisions aimed at making international data transfers easier may assist firms facing multi-jurisdictional investigations. However, given the heavy potential sanctions for breaching the new Regulation, firms will need to ensure that they have sufficient safeguards in place to avoid any potential breaches.

Blocking statutes

7.138 Blocking statutes can be a particular cause for concern in cross-border investigations because these laws commonly restrict or prevent the disclosure of information for foreign disclosure purposes.

7.139 For example, Article 271(1) of the Swiss Penal Code has developed into a de facto blocking statute that frequently obstructs international disclosure. The Swiss courts have interpreted Article 271(1), which prohibits official acts on Swiss territory on behalf of a foreign state, sufficiently broadly to encompass the taking of evidence for foreign proceedings. As a result, the gathering and compilation of evidence (including the collection of documents, taking of witness depositions and creation of written witness statements) are all considered official acts that can only be performed by Swiss authorities.

7.140 Article 271(1) also prohibits the facilitation of unauthorised acts on Swiss territory. As a result, anyone who facilitates another party to breach this provision may be criminally liable, regardless of the nature and extent of the assistance given. Therefore, as a general rule, in judicial or administrative matters, the collection of evidence must be done through official channels and processes for requesting legal assistance.

7.141 The French Penal Law No 80-538 also prohibits the 'requesting, seeking or disclosing [of] … documents or information … for the purposes of constituting evidence in view of foreign judicial or administrative proceedings'[1]. Breach of the Penal Code is punishable by a €18,000 fine and/or six months' imprisonment.

1 Statute N° 80-538 of July 16, 1980.

Regulators to help determine whether or not a person's conduct has complied with a Statement of Principle. An important point to keep in mind is that it is the Statements of Principle, not the Code of Practice, that are paramount. The Code of Practice only has evidential effect[2].

1 FSMA 2000, s 66(2)(a) and (2A)(a) although there are circumstances in which the Regulators can commence civil or criminal proceedings against an individual who is not an approved person, such as for market abuse (see **CHAPTER 17** below).
2 The effect of the Code of Practice is discussed in more detail at para **2.32** ff above.

9.15 The FS(BR)A 2013 extends the regime by enabling the Regulators to make 'rules' applicable to individuals, not just the Statements of Principle. Correspondingly, the grounds for disciplinary action relate to breaches of such rules. The Regulators will be able to bring disciplinary action against an approved person or another banking firm employee who breaches a rule applicable to him[1]. This is broader than a breach of a Statement of Principle by an approved person. These new rules could be extended to approved persons at non-banking firms or the existing Statements of Principle could continue to apply to those individuals. In either case, breaches by approved persons will still constitute misconduct for which the Regulators can bring disciplinary action.

1 FSMA 2000, ss 66A(2) and 66B(2) introduced by the FS(BR)A 2013.

Knowingly concerned in a contravention

9.16 The meaning of 'knowingly concerned in a contravention' is discussed at para **2.126** ff above. The question whether a person has been knowingly concerned in a contravention depends in part upon his knowledge at the relevant time. The meaning of 'contravention of a requirement imposed by or under the FSMA 2000' is considered at para **2.94** ff above.

9.17 This category of 'misconduct' for which disciplinary action can be brought is amended by the FS(BR)A 2013, which applies it both to approved persons at non-banking firms and to employees of banking firms (including senior persons) who are knowingly concerned in that firm's contravention of requirements under the FSMA 2000 or qualifying EU measures specified by the Treasury[1].

1 FSMA 2000, ss 66A(3) and 66B(3), which will come into force with the FS(BR)A 2013, although, at the time of writing, a commencement date has not been announced.

Misconduct by senior persons

9.18 The FS(BR)A 2013 introduces a new category of 'misconduct' as a basis for disciplinary action that applies only to senior persons at banking firms[1]. The conditions for this category of misconduct are met when:

- the person has been, at any time, a senior person at a banking firm;
- there has at that time been (or continued to be) a contravention of a requirement by that banking firm; and

- the senior person was, at that time, responsible for the management of any of the firm's activities in relation to which the contravention occurred or continued.

1 The FS(BR)A 2013 introduces the FSMA 2000, ss 66A(5) and 66B(5).

9.19 A person is not guilty of misconduct under this head if he can show that he took such steps as a person in his position could reasonably be expected to take to avoid the contravention occurring or continuing.

9.20 This reverses the burden of proof for senior persons. A finding that a banking firm has breached principles or rules (whether that finding appears in a final notice following a settlement or a contested process) will, prima facie, give rise to a presumption of misconduct on the part of one or more senior persons responsible for that area of the business. The statements of responsibility that banking firms must prepare for each senior person are likely to make it easier for the Regulators to identify which senior person is responsible for management of the firm's activities in relation to which the contravention occurred. The onus will then be on the relevant senior person to show that he took reasonable steps to avoid or put a stop to the regulatory breaches. It will therefore be critical for senior persons to be able readily to show how they exercise proper oversight over the activities for which they are responsible, so as to avoid breaches from occurring, and the steps taken to investigate and remediate issues which arise.

Appropriate in all the circumstances to take action

9.21 Each Regulator is required[1] to prepare and issue a statement of its policy with respect to the imposition and amount of penalties and the period for which suspensions or restrictions are to have effect and, in the case of any particular contravention, to have regard to the policy in force at the time the contravention occurred when exercising, or deciding whether to exercise, its powers. The Regulators' policies in this regard are discussed below[2]. However, the FSMA 2000 imposes the additional requirement that the Regulator concerned must be satisfied that it is appropriate in all the circumstances to take action against the person. Therefore it is clear that the mere fact that 'misconduct' can be attributed to an individual does not of itself mean that disciplinary action against an individual will result. This reflects what is one of the more difficult questions in this context, namely, in what circumstances should the Regulator look to punish an individual instead of, or in addition to, the firm?

1 FSMA 2000, s 69.
2 See para **9.23** ff.

When will the Regulators seek to discipline an employee?

9.22 It is rare that the firm commits a breach without one or more persons working for the firm having had some sort of involvement in that breach[1]. As has been seen, the FSMA 2000 gives the Regulators a broad discretion to decide

of access to relevant materials under the FSMA 2000, s 394[3]. Although it will not arise in relation to all warning notices provided for by the FSMA 2000, it will arise in the vast majority of cases[4].

1 A similar right will arise upon the issue of a decision notice: see para **10.172** below.
2 FSMA 2000, s 394. The RDC will take the decision as to whether to refuse access to FCA material relevant to the warning notice. See the FCA Handbook at DEPP 1.2.6G(3).
3 FSMA 2000, s 387(1)(d). See para above.
4 Cases which are excluded include where a warning notice is required to be issued where a firm has applied to vary or revoke action that has already been taken by the FCA. For a list of those cases where there will be a right of access to the FCA's documents, see the FSMA 2000, s 392.

What documents is the firm entitled to review?

10.119 The FCA is required to allow the firm access to certain types of material, in particular[1]:

- the material upon which the FCA (being the RDC) relied in taking the decision which gave rise to the obligation to give the warning notice (in other words, the decision by the RDC to propose that enforcement action should be taken). This can be described as 'primary material'; and
- any secondary material which, in the FCA's opinion, might undermine that decision. Accordingly, secondary material means[2] other material that has not been included within the above 'primary material', but which was considered by the RDC in reaching the decision or was obtained by the FCA staff in connection with the matter, but which was not considered by the RDC in reaching that decision[3].

1 FSMA 2000, s 394(1).
2 FSMA 2000, s 394(6).
3 See the Explanatory Notes to FSMA, produced by HM Treasury, para 693.

10.120 The firm's entitlement is subject to various exceptions which allow the FCA to refuse access to certain categories of material, in particular:

- material which was intercepted under a warrant that was issued under the interception of communications legislation or which may indicate that such a warrant was issued or that material has been intercepted in such a way[1];
- material that is covered by the statutory protection for legal privilege[2], in which case the FCA must give the firm written notice of the existence of the item and its decision not to allow the person access to it[3];
- material relating to a case involving a different person and which was taken into account by the RDC in this case only for the purposes of comparison with other cases[4]; or
- if, in the RDC's opinion, to allow the firm access to the material[5]:
  - would not be in the public interest; or
  - would not be fair having regard to: (i) the likely significance of the material to the firm in relation to the matter in respect of which it has been given the warning notice; and (ii) the potential prejudice to the commercial interests of another person which would be caused by the material's disclosure.

1 FSMA 2000, s 394(2) and (7)(a).
2 FSMA 2000, ss 394(2), (7)(c) and 413. For a detailed discussion, see para **5.56** ff above. Note that FSMA 2000 effectively contains its own definition of legal privilege for this purpose, which does not equate in all respects with the common law definition.
3 FSMA 2000, s 394(2), (4) and (7)(c).
4 FSMA 2000, s 394(2)(a) and (b). Such material ought to be taken into account, only for the purposes of assessing the appropriate sanction or punishment, and not in order to ascertain whether the person committed the breach.
5 FSMA 2000, s 394(3). If the FCA refuses to allow access to material on this basis, it must give the firm written notice of the refusal and the reasons for it: FSMA 2000, s 394(5).

10.121 These provisions setting out the firm's rights to access the FCA's material are complex. The scope of the FCA's obligation to provide access to material, and precisely what material will be accessible by the person, requires closer analysis. Firms need to be aware that the statutory provisions that permit access to the FCA's documents are not all embracing. Material may be taken into account by the RDC without the firm having any right to see or comment upon it. It is only in the Tribunal that the firm has a wider right of access to the documents[1].

1 This may depend upon what applications are made to the Tribunal with regard to disclosure, and the Tribunal's views in the particular case: see further para **12.73** ff below.

Primary material

10.122 The obligation to provide access to the material upon which the FCA relied is relatively straightforward. The obligation applies to the regulator that gives the warning notice and this should be read as referring to the RDC, since it is the RDC that will make, upon the FCA's behalf, the decision as to whether to issue the warning notice. One point that is unclear is the meaning of the word 'material'. The word 'material' is not defined in the FSMA 2000 (the words 'information' and 'documents' are more commonly used). It seems to derive from the Criminal Procedure and Investigations Act 1996[1], in which context it is defined as referring to material of all kinds and in particular includes information and objects[2]. Material is not, therefore, limited to documentary material[3]. Any legal advice upon which the RDC relied is not required to be disclosed[4].

1 'In broad terms we are persuaded that a case may be made for aligning the requirement [to provide access] more closely to the rules on disclosure that apply in criminal cases': Economic Secretary to HM Treasury in Standing Committee (9/12/99).
2 Criminal Procedure and Investigations Act 1996, s 2(4). The same issue, of whether non-documentary material should be provided, should not arise in the context of a criminal prosecution, because there is a duty on the prosecutor to record material which consists of information not recorded in any form: see para 4.1, Code of Practice issued under Pt II, Criminal Procedure and Investigations Act 1996. For a discussion more generally, see Archbold 2013, at **Chapter 18** below.
3 This appears to be supported by para 4.1 of the Code of Practice, which refers to 'material which … consists of information which is not recorded in any form'.
4 This is discussed further at para **10.127** below.

the warning notice or that he had reasonable grounds for not responding within the specified period. In such circumstances, if the DMC considers it appropriate, and the person to whom the notice relates gives their consent, it may decide to revoke the decision notice and the matter may be considered afresh or it may decide to give a further decision notice[1].

1 Notice and Decision Making Statement, para 29.

11.29 Following the giving of a decision notice, but before the PRA takes action to which the notice relates, the PRA may give the person concerned a further decision notice relating to a different action concerning the same matter, if that person consents[1].

1 FSMA 2000, s 388(3)–(4) and the Notice and Decision Making Statement, para 30 (which contains the procedure which will apply in these circumstances).

11.30 PRA staff responsible for recommending action to a DMC will continue to assess the appropriateness of the proposed action in light of any new information or representations received. It may be that they decide it is not appropriate to take the action proposed in a warning notice, or the action to which a decision notice relates, and in such circumstances the PRA must (except in certain limited circumstances) give a notice of discontinuance to the person to whom the notice was given[1].

1 FSMA 2000, s 389(1) and the Notice and Decision Making Statement, para 69. FSMA 2000, s 389(2) states that notices of discontinuance should not be given where the discontinuance of proceedings results in the granting of an application made by the person to whom the notice was given.

FINAL NOTICES

11.31 If the PRA has given a person a decision notice and the matter is not referred to the Tribunal within the required period, the PRA must, on taking the action to which the decision notice relates, give the person concerned and any person to whom the decision notice was copied a final notice[1]. A final notice must also be issued where the matter is referred to the Tribunal and the Tribunal (or higher court) directs that it be given[2]. The PRA has not published any statement on the procedure around the issuing of final notices, but final notices issued by the PRA must set out the terms of the action the PRA is taking[3] (as with a final notice issued by the FCA (see para **10.192** above).

1 FSMA 2000, s 390(1).
2 FSMA 2000, s 390(2)–(3).
3 FSMA 2000, s 390 (3)–(7) and the Notice and Decision Making Statement, para 7.

PUBLICITY REGARDING DECISION AND FINAL NOTICES

11.32 As for the FCA (see **CHAPTER 10**), the PRA must publish such information as it considers appropriate about the matters to which a decision notice and final

notice relate[1]. However, as with warning notices (see para **11.19** ff above), the PRA may not publish information concerning a decision or final notice which would be unfair to the persons concerned, prejudicial to the safety and soundness of PRA-authorised persons or prejudicial to securing the appropriate degree of protection for policyholders[2].

1 FSMA 2000, s 391 and the Publicity Statement, para 12.
2 FSMA 2000, s 391 and the Publicity Statement, para 13.

11.33 The decision as to whether to publish any details concerning a decision or final notice will be made by the same committee which took the decision to issue the notice[1]. As with warning notices, when it proposes to publish details of a decision or final notice, the PRA will consider any representations made to it by the subject of the notice and any person to whom the notice is copied[2].

1 Publicity Statement, para 20.
2 Publicity Statement, para 15. As noted above at para **11.19**, such representations should normally be made in writing and should contain detailed information (with reference to the test in the FSMA 2000, s 391) as to why it would not be appropriate for the PRA to publish details of the notice.

11.34 Publicity relating to decision and final notices will generally include placing the relevant notice on the PRA's website[1]. As with warning notices, the PRA will on request review the notice and any related press release published on its website to determine whether (at the time of the request) continued publication is appropriate, or whether they should be removed or amended[2].

1 Publicity Statement, para 22. Paragraph 23 of the Publicity Statement also states that, in relation to final notices, the PRA should also consider what matters it should notify to the FCA for inclusion on the FCA's public register under the FSMA 2000, s 347A.
2 Publicity Statement, para 24. As noted in relation to warning notices, in determining whether this is appropriate, the PRA will take into account various factors including whether it has continuing concerns in respect of the person, how much time has passed since publication and any representations made by the person.

SETTLEMENT

11.35 The PRA's 'Statement of the PRA's settlement decision-making procedure and policy for the determination of the amount of penalties and the period of suspensions or restrictions in settled cases'[1] (the Settlement Statement) sets out the PRA's policy on the settlement of enforcement action by the PRA.

1 The 'Statement of The PRA's approach to enforcement' is contained at Appendix 4 of the April 2013 Statement.

11.36 **CHAPTER 10** considered how settlement operated in the FCA enforcement regime; most of the issues discussed in that chapter with regards to settlement (such as when settlement discussions will take place, whether the firm has to take part in settlement discussions and whether the firm can be candid in its settlement discussions) will also be relevant when considering settlement in relation to a PRA enforcement action.

conduct of business rules is beyond the scope of this book but, broadly, they cover matters such as communications with customers, the information to be provided to customers (both before and after sale), and the conduct of the sales process, including the standards for any advice that is given.

1 See, in particular:
- FCA Handbook at Conduct of Business Sourcebook (COBS);
- FCA Handbook at Insurance: Conduct of Business Sourcebook (ICOBS);
- FCA Handbook at Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB);
- FCA Handbook at Banking: Conduct of Business Sourcebook (BCOBS).

13.14 Although there are instances where enforcement action proceeds on the basis that a firm's activities have breached one or more specific conduct of business rules, such cases have become much less frequent. This is because the FCA's regulatory framework is informed by a set of principles and higher-level rules which allow the FCA greater flexibility when dealing with mis-selling[1]. It is for this reason that the specific rules are generally only the starting point.

1 Firms must also be mindful of statutory and common law causes of action available to claimants wishing to pursue a civil remedy. This is considered at para **19.83** ff below.

Principles for Businesses and consumer outcomes

13.15 The shift to principles-based regulation means a greater emphasis being placed upon compliance with the Principles (and other, similar, high level rules) and the related consumer outcomes. The Principles are listed in para **2.12** above. Principle 6, which requires firms to pay due regard to the interests of consumers and to treat them fairly, is at the core of the FCA's approach to combating mis-selling. Other principles that are particularly relevant in the context of mis-selling for firms which have dealings with consumers or which create financial products for onward sale to consumers are Principles 7 and 9[1].

1 Principle 7 requires firms to pay due regard to the information needs of clients and to communicate information to them in a way that is clear, fair and not misleading. Principle 9 requires firms to take reasonable care to ensure the suitability of the firm's advice and of any discretionary decisions for customers entitled to rely on the firm's judgement.

13.16 The Principles operate at a high level of generality and the question of what conduct is required of firms in order to comply (and to protect themselves against subsequent allegations of mis-selling) develops over time as regulatory thinking evolves. This evolution is articulated in a variety of enforcement decisions, thematic reviews, regulatory guidance and speeches. One of the significant challenges for firms is to keep up with these developments, so as to consider when and how to adapt their own processes as necessary.

13.17 The open-textured nature of the Principles makes it difficult for firms to assess whether they are complying with them, and so a set of 'consumer outcomes' sits alongside the Principles, and articulates the objective, from a consumer perspective, that the FCA wishes firms to achieve. Compliance with the Principles increasingly is judged by whether these outcomes have been achieved for the consumers concerned. The six consumer outcomes are:

- *Outcome 1*: consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture;
- *Outcome 2*: products and services that are marketed and sold in the retail market are designed to meet the needs of identified consumer groups and targeted accordingly;
- *Outcome 3*: consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
- *Outcome 4*: where consumers receive advice, the advice is suitable and takes account of their circumstances;
- *Outcome 5*: consumers are provided with products that perform as firms have led the consumers to expect and the associated service is both of an acceptable standard and as consumers have been led to expect;
- *Outcome 6*: consumers do not face unreasonable post-sale barriers imposed by firms to changing products, switching provider, submitting a claim or making a complaint.

Practical tips for firms

13.18 In practice, given the breadth of the Principles and 'consumer outcomes', the constant evolution of regulatory standards, and the concern to avoid consumer detriment, 'mis-selling' has often been assessed with the benefit of hindsight. It has been difficult for firms to know what compliance involves. However, there are a number of recurrent (and connected) themes, which help firms to reduce the risks.

13.19 First, the FCA expects firms' business models, culture and operations to be based on a foundation of fair treatment of consumers. It wants this to be embedded into a firm's culture, corporate strategies and day-to-day operations. One aspect of this is that the FCA wants problematic trends to be identified quickly and addressed. This has implications for governance and management information (see para **13.20** below). Increasingly, firms need to be aware of how consumers experience financial services and products. A firm will be better protected if it can show that relevant decisions (for example, as to a product's features, the appropriate sales process, or in dealing with after the event issues like redress) were made from the perspective of customers, rather than purely in the firm's commercial interests.

13.20 Second, the FCA wants to see effective structures in place for the governance and oversight of financial products. This links in closely with the responsibilities of senior management, as effective governance structures can help to demonstrate that the relevant individuals discharge their own responsibilities to manage, and maintain an appropriate degree of oversight over, the business for which they are responsible. Such structures can therefore protect both the firm and its senior management. Governance bodies depend upon the management information that they receive, and so it is critical that

- circumstances suggesting a serious problem within the firm or with the firm's controllers[2] that calls into question the firm's ability to continue to meet the threshold conditions.

1 FCA Enforcement Guide at EG 8.8.
2 Broadly, this refers to a person who exercises control over the firm: see the Glossary to the Handbook.

16.120 The FCA also needs to consider whether the urgent exercise of its powers is an appropriate response to such concerns. The FCA has indicated that, in doing so, it will consider the full circumstances of the case, but has identified a number of factors that may be relevant, including the following[1]:

- the extent of any loss or risk of loss or other adverse effect on consumers;
- the extent to which customer assets appear to be at risk;
- the nature or extent of any false or inaccurate information provided by the firm;
- the seriousness of any suspected breaches and the steps that need to be taken to correct them;
- the financial resources of the firm, particularly where the firm may be required to pay significant compensation to consumers;
- the risk of the firm's business being used to facilitate crime;
- the risk that a firm's conduct or business presents to the financial system;
- the firm's compliance history and its conduct since the issue arose; and
- the impact that the use of the powers will have on the firm's business and its customers, including the effect on the firm's reputation and on market confidence[2].

1 For a full but non-exhaustive list of factors the FCA may consider, see FCA Enforcement Guide at EG 8.9.
2 The Regulators recognise the need to be satisfied that the impact of any own-initiative action is proportionate to the concerns being addressed, in the context of the overall aim of achieving their statutory objectives (FSMA 2000, s 3B).

16.121 The use of words such as 'information indicating', 'circumstances suggesting' and 'suspected breach' in the FCA guidance reflects an important distinction between urgent own-initiative action and other types of regulatory action: it is normally taken by the Regulators on a summary basis, without the firm having any opportunity to be heard, any review of the decision or challenge only taking place afterwards. The Regulators will be considering whether to take action not following an exhaustive enquiry but, on a summary basis because of particularly serious concerns and based on the information available to them at the time. The potential ramifications of taking action on this basis should mean that the power is only used when justified by the seriousness and immediacy of the concerns. In practice, such action is taken quite regularly.

Cancellation

16.122 Cancellation of permission is the most serious application of the Regulators' own-initiative power. As discussed in para **16.31** above, the statutory grounds for cancellation are the same as variation. Whether the Regulator decides to vary or cancel the permission depends on the circumstances: for example, the type of behaviour the Regulator is seeking to address. The question of cancellation of permission does not arise in relation to incoming firms, save to the extent they have a 'top-up permission'. Subject to this, the Regulators have:

- the right, in relation to Cases A to D[1], not only to vary a firm's permission but to cancel it; and
- in any case, a duty to cancel the firm's permission if, as a result of varying a firm's permission, there are no longer any regulated activities for which the firm has permission and where the Regulator is satisfied that it is no longer necessary to keep the permission in force[2].

1 These are four of the tests for the imposition of the Regulators' own-initiative powers and are discussed at para **16.32** above.
2 FSMA 2000, s 55J(8).

16.123 The FCA will consider cancelling a firm's permission in two main circumstances[1], namely:

- where it has very serious concerns about a firm, or the way that its business is or has been conducted; or
- where the firm's regulated activities have come to an end and it has not applied for cancellation of its permission[2].

1 FCA Enforcement Guide at EG 8.13.
2 A Regulator may cancel a firm's permission where the firm has not conducted regulated activities for a period of at least 12 months.

16.124 The first of these is the main, general criterion. The underlying concern is the Regulators' obligation to ensure that the firm satisfies, and will continue to satisfy, the threshold conditions[1].

1 FSMA 2000, s 55B(3).

16.125 The grounds for cancelling a firm's permission are the same as for varying it and where the Regulator varies a firm's permission by removing all regulated activities, the effect will be similar[1]. Apart from the procedure for taking the action which is considered at para **16.130** below, the main difference is that cancellation of permission cannot take place with immediate effect and therefore, where action needs to be taken urgently, the Regulator may vary a firm's permission before cancelling it. In practice, a firm's permission can be varied in such a way so as to have the same effect as cancellation, for example by removing all of the firm's regulated activities. In urgent and serious cases, this is how the Regulator will deal with the issue.

1 FCA Enforcement Guide at EG 8.14 and para **16.128** ff below.

2 See Consultation Paper 10, 'Market Abuse. Pt 1: Consultation on a draft Code of Market Conduct', paras 145 and 146.
3 Economic Secretary to HM Treasury in Standing Committee (2 November 1999).

17.120 As set out above, certain of the market abuse offences can occur in relation to any of the EU regulated markets and not simply one of the UK recognised investment exchanges or recognised auction platforms[1]. Further under EU law[2] regulators in each EU state are empowered to police not only activities on their own regulated markets but also activities that take place within their territory that relate to trading on regulated markets in other EU states. There is, therefore, a likelihood of regulators in more than one jurisdiction having an interest in investigating the same trading activity. Following the implementation of the MA Regulation, ESMA is likely to also have a greater role in cross border investigations as it will take over the coordination of such investigations if requested to do so by one of the national regulators concerned.

1 FSMA 2000, s 118A(2) and para **17.35** ff above.
2 See the MAD, arts 10 and 14. This will remain the case under the MA Regulation. The obligations to cooperate with and provide mutual assistance to regulators of other Member States will be strengthened under the MA Regulation. National regulators will also be authorised to permit a national regulator from another Member State to carry out an on-site investigation or inspection within their territory.

Formal market misconduct investigations

17.121 The FCA, or the Secretary of State, may appoint an investigator to conduct an investigation if it appears to it that there are circumstances suggesting that market abuse may have taken place or one of the criminal offences of insider dealing or misleading statements and practices or misleading statements and practices in relation to benchmarks may have been committed[1].

1 FSMA 2000, s 168(2).

The test for appointing an investigator

17.122 The test for appointing an investigator is fairly low. The FCA does not need to be satisfied or have reasonable grounds for believing that market misconduct has taken place. All that is required are circumstances suggesting this. Most notably, it is not necessary for the FCA to be able to identify, at the outset of the investigation, any person who may have engaged in the suspected market misconduct. This allows the FCA to commence an investigation based on, for example, information received from an exchange showing suspicious or inexplicable movements in the price of a particular investment.

17.123 The suspicion must be that market misconduct has already taken place; the FCA does not have power under this head to investigate market misconduct which it suspects may take place on some future date. The FCA does, however, have the ability to apply to the court for an injunction to prevent a person engaging in market abuse in the future, which the court may grant if satisfied that

there is a reasonable likelihood that any person will engage in market abuse[1]. If the FCA has a suspicion that market abuse may occur, but insufficient evidence to obtain an injunction, then it will need to find another means of investigating. That should not be difficult where a firm is involved but may be more difficult as against those who are not regulated.

1 See *Financial Services Authority v Da Vinci Invest Ltd [2011] EWHC 2674 (Ch)* in which Newey J found that the FSA did not have to establish market abuse definitively to obtain interim relief, however note that the FSA had been unsuccessful in obtaining a without notice injunction to restrain market abuse in a previous application in the same proceedings. See also *FSA v Alexander (unreported)* and the *Barnett Michael Alexander final notice (14/6/11)*. Mr Alexander's activity was brought to the FSA's attention as a result of a suspicious transaction report in December 2009. In May 2010 the FSA brought proceedings against Mr Alexander under s 381 of the FSMA 2000 and obtained an interim injunction freezing Mr Alexander's assets and preventing him from continuing to enter into the particular conduct that concerned the FSA. This is discussed further at para **17.229** ff below.

What can be investigated?

17.124 The FCA can investigate suspected market abuse, or one of the criminal offences, or both, and will need to define the scope of the investigation accordingly. However, having commenced an investigation, there can be one investigation into all aspects of the suspected market misconduct: the decision in the more serious cases of whether to commence civil proceedings for market abuse or criminal proceedings for insider dealing or misleading statements and practices does not need to be taken at the outset.

17.125 In less serious cases involving firms or approved persons, it may be that once the investigation starts it will become apparent that market abuse has not occurred and what is instead being investigated is a suspected breach of the Principles[1]. Provided it appeared to the FCA at the outset that there were circumstances suggesting market abuse, the investigation will have been commenced on the correct basis and there does not seem to be anything to prevent it proceeding on that statutory basis notwithstanding market abuse is no longer at issue[2].

1 In particular, Principle 5 of the Principles for Businesses or Statement of Principle 3 of the Statements of Principle for approved persons: see paras **17.256** ff below. See also the *Citigroup Global Markets Limited final notice (28/6/05)* for an example of breaches of Principles 2 and 3.
2 The advantage for the investigator is that a market abuse investigation confers wider powers than one into suspected breaches of FCA rules or the Principles. This is discussed further at para **5.53** above.

Investigations by the Secretary of State

17.126 The Secretary of State has concurrent power to appoint investigators for suspected cases of market abuse, insider dealing and/or misleading statements and practices and/or misleading statements and practices in relation to benchmarks. The reasons for this are discussed at para **5.27** above.

The overlap between civil claims and enforcement powers

19.73 As already seen, the Regulators have a wide range of enforcement powers available for a variety of purposes. One of the objectives of the FSMA 2000 is the protection of consumers[1] and this is reflected in the availability of various enforcement powers and other mechanisms designed to secure compensation for consumers who have incurred losses as a consequence of regulatory breaches. Thus, for example:

- the FCA or PRA can impose or ask the court to impose a restitution order[2];
- the FCA or PRA can apply to the court for an injunction requiring the firm to remedy its breach[3];
- individual customers may seek compensation through the firm's complaints procedure and the FOS[4]; and
- the firm will in any event need to consider compensating customers voluntarily as part of its own response to the regulatory issue[5] and, as noted above, the FOS now has a regulatory role in setting the standards by which firms must adjudge their potential liability, by account of the FOS's published online decisions as well as decisions they receive directly from the FOS when considering customer complaints[6].

But if the firm makes payments to compensate customers on any of these bases, to what extent does that prevent the customer from bringing further claims against it?

1 For a discussion of the regulatory objectives, see **Chapter 1** above.
2 See para **8.100** ff above.
3 See para **8.138** ff above.
4 See **Chapter 14** above.
5 The importance of the firm dealing appropriately with its customers when a matter of regulatory concern arises is discussed at para **3.106** ff above and para **13.53** ff above.
6 See para **19.16** above.

19.74 There are two reasons why in practice this matters. First, the basis upon which, for example, restitution is ordered or on which the FOS awards compensation, is rather different from that on which a court awards damages. The most notable example is the cap on FOS awards[1], but there are other differences[2]. There may therefore be a difference between the customer's legal entitlement to damages and the amount that he receives under the FSMA 2000, or is paid voluntarily by the firm. If the customer receives significantly less compensation than he could obtain if he pursued his strict legal rights, then further legal claims may be in prospect. Second, the customer could try to argue that any payment he received was voluntary so far as he was concerned, and did not affect his strict legal rights. In other words, he might try to recover twice. The legal effect of any compensation paid is therefore important.

1 At the time of writing, the cap was £150,000 for claims received on or after 1 January 2012.
2 In imposing a restitution order, the FCA or PRA or, as appropriate, the court will require the firm to pay such amount as is considered 'just' having regard to, among other things, the amount of the losses: see para **8.127** above. The test for the FOS is to award 'fair compensation' for the loss

or damage: see **Chapter 14** above. Not only do these tests not necessarily equate with each other, neither need equate with the complex common law rules on the assessment of damages which would apply to a civil claim.

19.75 As a general rule – known as the rule against double recovery – a person is entitled to recover only his net loss. According to this rule, the process of determining the amount of a person's net loss will usually (but not always) take into account any amount he has gained that he would not otherwise have received[1]. There are exceptions to this rule, which may or may not apply in a given case depending on the circumstances and considerations of justice, reasonableness and public policy[2]. The authorities underpinning the rule against double recovery provide strong support for the proposition that payments voluntarily made by a firm to its customer will be taken into account in determining the amount of the customer's net loss. The basic position should therefore be that any amounts the firm pays over to the customer should be taken into account in assessing the damages that the customer can recover in a subsequent civil claim. This basic position does not appear to be changed by the relevant provisions of the FSMA 2000[3].

1 *Hussain v New Taplow Paper Mills Ltd [1988] AC 514* at 527 (Lord Bridge) and see also *Hunt v Severs [1994] 2 All ER 385, HL.*
2 Lord Reid in *Parry v Cleaver [1970] AC 1* at 13; and see *Hussain* at 528; and *Hunt v Severs* at 3823. There are two well-established categories of exception. First, in the insurance context, an insurer's payment to the insured does not extinguish the insured's rights against the wrongdoer; however, so as to avoid double recovery, the insurer is entitled, by subrogation, to benefit from those rights in place of the insured. Second, donations received from benevolent third party donors, motivated by sympathy for the claimant's misfortune, are also generally not taken into account. As to the second category, compare *Rubenstein v HSBC Bank plc [2012] EWCA Civ 1184*, in which a latent payment to the plaintiff made by a failed fund in which the plaintiff had invested, which was expressed as having been made on an ex gratia basis despite there being no contractual entitlement to it, was held not to have fallen within the exception, on the basis that it was not made out of pure benevolence but rather as a continuation of the original transaction and not as a matter entirely collateral to it.
3 The analysis depends upon the following: (i) where the court grants a restitution order, whether or not for market abuse, the FSMA 2000 provides that 'Nothing in this section affects the right of any person other than the FCA or PRA or the Secretary of State to bring proceedings in respect of the matters to which this section applies' (FSMA 2000, ss 382(7) and 383(9)). This appears to address only the question of whether proceedings can be brought, not what is recoverable in those proceedings, and not therefore to affect the general position outlined above; (ii) where the court grants an injunction, the FCA or PRA uses its administrative powers to make a restitution order, or the firm pays compensation voluntarily, the FSMA 2000 is silent on the effect as regards other potential claims. Again, it is thought that there is nothing to dislodge the general principle; and (iii) if the FOS makes an award under the compulsory jurisdiction, which is accepted by the complainant, then the FSMA provides that the award is binding on both the firm and the complainant (FSMA 2000, s 228(5)).

19.76 The Court of Appeal has resolved some uncertainty regarding the recovery of compensation through civil proceedings after a customer has accepted a FOS determination. The Court of Appeal held that if a customer accepts a FOS determination, he or she is not able to seek additional compensation from the firm through the courts if the cause of action relied on is constituted by the same set of facts as the determined complaint. This is because the doctrine of res judicata applies to the FOS's determination[1].

1 *Clark v In Focus Asset Management & Tax Solutions Ltd [2014] EWCA Civ 118.*