



**WORKING PARTY PAPERS**

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**Financial Services Regulation:  
Enforcing the New Regime**

**Comments on the Financial Service Authority's Consultation  
Paper 17**

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## **1 Introduction**

- 1.1 The Fraud Advisory Panel is an independent body established by the Institute of Chartered Accountants in England & Wales to advise on fraud and connected matters. One of the Panel's working parties is the Investigation and Prosecution Working Party, on behalf of which these comments have been prepared. The Working Party consists of lawyers and accountants with expertise in fraud, financial services and connected areas.
- 1.2 These comments are our response to the FSA's Consultation Paper 17 "Financial services regulation. Enforcing the new regime" of December 1998. We are grateful to the FSA for granting an extension to us for submission of our comments.
- 1.3 In this document, references to "the Bill" are references to the Financial Services and Markets Bill, and all references to "Clauses" are references to clauses in the Bill and, unless otherwise stated, references to paragraphs are references to paragraphs in the FSA's Consultation Paper. References to the "Convention" are references to the European Convention on Human Rights.

## **2 Primary Conclusions**

- 2.1 The FSA's proposed decision making and adjudication process is fundamentally flawed, and undermines the independent and impartiality of those carrying out adjudication functions, including the Enforcement Committee, as it (inter alia) fails to separate such functions from the investigation and prosecution functions (see paragraphs 8.8-8.9 below).
- 2.2 The FSA's proposed system is likely to be in breach of Article 6 of the Convention (and, therefore, the Human Rights Act 1998) (see paragraph 8.9 below).
- 2.3 Accordingly, the FSA's objectives (that its proposed system should provide proper and appropriate safeguards and be fair, and be seen to be fair) are not and will not be met by such a system (see paragraph 8.10 below).
- 2.4 In order to comply with the Convention (and, therefore, the Human Rights Act 1998), and with existing domestic law, and to meet the FSA's own objectives, and to ensure a fair and transparent system, the adjudication function of the FSA should be separated and ring-fenced from its investigation and prosecution functions and, as the FSA intends the Enforcement Committee to have a role in FSA prosecution (and, possibly, investigations), that Committee should not have any adjudication function, but instead such function should be carried out by an independent and impartial first instance tribunal (see paragraph 8.11 below).
- 2.5 The first two components of the FSA's three-component system (FSA, Enforcement Committee and Appeal Tribunal) do not meet the criteria of legality, fairness, independence and impartiality in relation to the adjudication process, and if such criteria are to be met a four-component system (FSA, Enforcement Committee, first instance Tribunal (for disputed cases) and an Appeal Tribunal) is required (see paragraph 8.11 below).
- 2.6 The FSA's proposed fines system, by which it will impose fines in amounts decided by it, and which will be paid to and used by it, creates a conflict between its investigation and prosecution roles on the one hand and its adjudication role on the other, and is likely to be in breach of Article 6 of the Convention (see paragraphs 6.13-6.14 below). Steps should be taken to ensure that the person (or body) deciding on the amount of the fine is ring-fenced from the investigation and prosecution of the case.

- 2.7 Neither the Bill nor the FSA's proposed system provide sufficient safeguards against any abuse of power or process by the FSA. If only for the avoidance of doubt, the Bill should clearly spell out that the Human Rights Act 1998 (and, therefore, the Convention), and judicial review and declaratory judgements are to be available in appropriate cases as remedies against the FSA (see paragraph 9.1 below).
- 2.8 The proposal that the FSA should be able to bring proceedings where the behaviour in question is not actually a breach but is closely analogous to behaviour which would constitute a breach of an FSA Rule, Code or evidential provision, is likely to be in a breach of Articles 6 and 7 of the Convention and causes us serious concern as it is not only unfair, but makes for uncertainty (see paragraphs 6.9-6.10 below).
- 2.9 The power to enter premises (Clause 101 of the Bill) should only be exercisable with the written consent of a Chairman of the Enforcement Committee and, save in exceptional circumstances, such consent should be obtained in advance (see paragraph 4.2 below). The power to apply for and the grant of a warrant to enter premises (Clause 102 of the Bill) should be subject to the same safeguards as exist for warrants applied for under the Police and Criminal Evidence Act 1984 and the Criminal Justice Act 1997 (see paragraph 4.2 below).

### **3 Section 2 - Intervention**

- 3.1 The FSA will (inter alia) have powers to intervene in the business and affairs of Authorised Firms (paragraphs 20-29) but the exercise of such powers may differ as between urgent and non-urgent cases. It will also have power to impose requirements on such firms (paragraphs 30-31).
- 3.2 In addition to such powers, the FSA will also have powers \*under the Bill) to petition for the winding up of an Authorised Firm and to seek an injunction to restrain continuing or threatened breaches of requirements imposed on such firms by or under the new legislation (paragraphs 32-35) (and, under the common law, will be able in appropriate circumstances to apply for a Mareva injunction).
- 3.3 The FSA will also be able to exercise its intervention powers at the request of or for the purpose of assisting an overseas (EEA) regulator, and intends to exercise such powers if such a request is made and the FSA is satisfied that the use of its intervention powers is appropriate (paragraphs 36-40).
- 3.4 The FSA proposes to make public the fact that it has taken intervention action against a firm where it is appropriate in order to protect the interests of consumers, maintain confidence in the financial system and/or to reduce the risk of financial crime (paragraph 41).
- 3.5 We have no comment to make on the FSA's approach to the use of these above powers.

### **4 Section 3 - Investigation**

- 4.1 Clauses 96-100 of the draft Bill provide the FSA with a considerable range of information gathering and investigation powers to assist it in the discharge of its functions. In addition, the FSA or its investigators will have power to enter business premises occupied by an Authorised Person or Appointed Representative to obtain information or documents (Clause 101 of the Bill) and, in certain circumstances, power to seek a warrant authorising entry to any premises (using reasonable force if necessary) in order to search for and take possession of relevant documents (Clause 102).

- 4.2 We believe that the power to enter premises under Clause 101 of the Bill should only be exercisable with the written consent of one of the panel of Chairmen (as to which see paragraph 8.12) of the Enforcement Committee and, save in exceptional circumstances, such content should be obtained in advance. In addition this power should only be exercisable in exceptional cases, and the categories of such cases need clearly to be defined in the Bill. Further, we believe that the power to apply for a warrant under Clause 102 should be subject to the same safeguards as exist for warrants applied for under the Police and Criminal Evidence Act 1984 and the Criminal Justice Act 1987.
- 4.3 Except for the above, we have no further useful comment to make as to the FSA's proposed approach when considering the use of its investigation and information gathering powers (paragraphs 42-55).
- 4.4 As a general rule, the FSA proposes to notify any person who is the subject of an investigation by it of that fact, but will not do so if this would prejudice the FSA's ability effectively to conduct the investigation (paragraph 57). We agree with this approach, and believe it strikes the right balance. Where the FSA does so notify a person, it should also take reasonable steps to keep that person informed of the progress of the investigation.
- 4.5 We agree (paragraph 59-60) that the FSA should not normally public the fact that it is (or is not) conducting an investigation into a particular matter. We also agree that there may be exceptional circumstances in which a public announcement that the FSA is conducting an investigation is desirable in order to maintain public confidence in the financial system, protect consumers or to facilitate the investigation itself (paragraphs 59-60). As to the latter, we would expect the FSA, before making public for this reason the fact that it is conducting an investigation, to ensure first that prima facie evidence exists to show that misconduct has actually occurred, and that there is a legitimate and identifiable ground for believing that the investigation itself will be facilitate by publicity. We have no comment to make on the question of any other circumstances in which the FSA should make public the fact that it is conducting an investigation.
- 4.8 We agree with the proposal (paragraphs 61-64) that the FSA should not generally publicise the information found or conclusion reached during an investigation but, where enforcement action is taken, it will give appropriate publicity to such action. We also agree (paragraph 64) that, exceptionally, it may be desirable for the FSA to make the outcome of investigation public - an example where the fact of the FSA investigation has become public knowledge and such investigation does not confirm any FSA concerns (and/or the firm wishes the FSA to make that public).
- 4.7 The FSA's compulsory investigation powers will permit it to compel answers to questions from certain persons, including persons whose conduct is the subject of the investigation. However, the FSA will not be able to use the answers to such questions as evidence in criminal proceedings brought against the person giving the answers (except where the offence being prosecuted relates to a failure to answer questions truthfully) (see *Schenk v. Switzerland (1998) 13 EHRR 242*, and *Saunders v. UK (1996) 23 EHRR 313*). However, the FSA (rightly) considers (paragraph 68) that this should not prevent it from exercising its compulsory investigation powers in cases where it appears that (or, we would add, merely because) a criminal offence may have been committed. The exercise of such powers will, we accept, often be necessary to enable the FSA to conduct a thorough investigation into matters of concern. As these compulsory investigation powers include the power to require persons (including the person under investigation) to answer questions and produce documents, and failure to comply with such requirement will be a criminal offence, we feel it is important that they are used selectively, responsibly, fairly and only where necessary (an approach which appears to be acknowledged in part in paragraph 56).

- 4.8 Where the FSA's enquiries may lead to the institution of criminal proceedings against persons who have been required to answer questions under compulsion, in fairness to such persons the FSA intends that they should be given an opportunity to answer the FSA's questions so that such answers can be put before the criminal court in any subsequent prosecution (paragraph 69). Such an interview would be conducted in accordance with the Police and Criminal Evidence Act 1984 and be under caution (with a copy of it being provided to the interviewee).
- 4.9 Subject to what we say elsewhere in this response, we consider that the FSA's approach to investigations strikes a correct balance between ensuring the effectiveness of FSA investigation and fairness to persons who may be the subject of criminal prosecution following such investigation.

## **1 Section 4 - Securing Redress for Consumers**

- 1.1 Clause 206 of the Bill will enable the FSA to require an Authorised Firm that has breached regulatory provisions to make restitution to persons who have suffered loss or been otherwise adversely affected as a result of the breach (paragraph 72). The FSA's Rules will require Authorised Firms to have adequate arrangements for dealing with consumer complaints, and also there is to be a Financial Services Ombudsman, who would deal with complaints by aggrieved consumers who are not satisfied with the response from an Authorised Firm. The Ombudsman will have power to require the payment of compensation by such a firm (paragraph 73). Further, where an Authorised Firm is unable to meet its liabilities to consumers, the compensation scheme to be set up under provisions contained in the Bill will provide protection for consumers who suffer loss as a result, but consumers would in appropriate cases also be able to take private civil action (paragraph 74).
- 5.2 Where losses have occurred as a result of regulatory breaches, the FSA proposes that it will take action to secure redress only in those cases where such action provides a more effective and efficient route for protecting the interests of consumers than the other avenues available for securing redress (paragraph 75). Where it considers that it is appropriate to take action to secure redress for consumers, the FSA will first seek to agree appropriate compensation arrangements with the firm concerned and will only consider the exercise of its statutory powers to secure restitution on behalf of customers where such agreement is not possible (paragraph 76). The FSA does not regard it as part of its function to secure compensation for consumer losses that have occurred otherwise than as a result of a breach of the requirements imposed on Authorised Firms or under the legislation (paragraph 77). We agree with the FSA's general approach as set out in paragraphs 71-77 to the use of its powers to seek redress for consumers.

## **6 Section 5 - Discipline of Authorised Firms and Approved Persons**

- 6.1 The Bill (Clauses 135-6) will inter alia make available to the FSA the formal disciplinary measures of public censure and fines. Where an Authorised Firm contravenes the requirements of the Bill or the FSA's Rules (including the proposed Principles of Businesses), or an Approved Person fails to comply with a Statement of Principle issued by the FSA or has been knowingly concerned in a contravention by an Authorised Firm of a requirement imposed by or under the Bill, the FSA will be able to issue a public censure and/or to require the payment of a financial penalty (a fine) from such firms and persons.
- 6.2 The FSA will also have powers to withdraw authorisation, revoke or vary a permission, or withdraw approval, or prohibit an individual from being employed in connection with regulated activities (paragraph 79).

- 6.3 The FSA accepts that not all breaches of the FSA's Rules or the requirements of the bill will warrant formal disciplinary action, and that it will consider the use of informal, non-public measures where it believes that this adequately addresses the failure in question (paragraph 81).
- 6.4 The FSA believes that the exercise of its powers to impose a financial penalty and/or make a public statement in appropriate cases will serve to act as a deterrent to the firm or person concerned and others, and to ensure that those who breach their regulatory obligations pay a penalty which will go towards the overall costs of regulating the financial services industry (paragraph 82). The FSA takes the view that disciplinary action can accordingly assist it in pursuing its statutory objectives (paragraph 83).
- 6.5 We agree with the overall aims and objectives of disciplinary action against Authorised Firms.
- 6.6 As to the criteria for determining whether to take disciplinary action, the FSA intends to consider all the circumstances of each case, including the nature and severity of the breaches, the conduct of the relevant firm and person, and other factors (such as the previous record of such a firm or person, and the impact any disciplinary sanction would have on the firm's customers or its ability to meet its regulatory requirements) (paragraph 84). We have no comment to make on the relevant criteria.
- 6.7 In relation to the discipline of Approved Persons, as we have not seen the Principles and Codes of Practice, which are to be published by the FSA and will outline the standards of conduct to be expected of such persons, we cannot make any useful comment on paragraphs 85-90.
- 6.8 The FSA intends that its regulatory requirements will include two sets of Principles - Principles for Businesses and Principles for Approved Persons, which (as the practical application of the Principles needs to be reasonably predictable) will be fleshed out by a combination of Rules, evidential provisions (including Codes of Conduct) and guidance. The FSA will regard it as legitimate in certain circumstances to take disciplinary action based exclusively on a breach of one or more of the Principles.
- 6.9 The FSA is "conscious of the concern that Principles should be brought to bear in a way that is fair", and shares that concern. It "will not involve the Principles as a basis for disciplinary action in an arbitrary and unpredictable fashion". However, if the Principles are to be effective in achieving their purpose, the FSA believes it is important that it should take action to enforce such Principles where
1. there is evidence of systematic and repeated breach of detailed Rules; or
  2. it is clear that the conduct in question violates the Principles, regardless of whether any detailed Rule or evidential provision has strictly been breached; or
  3. the behaviour in question is closely analogous to behaviour which would constitute a breach of a detailed Rule, Code or evidential provision (our emphasis).
- 6.10 We have serious concerns that the third category of proceedings (the "closely analogous" behaviour category) if fraught with danger and uncertainty and will almost certainly be found to be in breach of Articles 6 and 7 of the Convention either behaviour is clearly prohibited or it is not and, if no relevant Principle or Rule prohibits it, such conduct is not prohibited and is not punishable by the FSA, and for the position to be otherwise would not be "fair" (see Article 6.1 of the Convention) and would be unacceptable. Persons whose behaviour is in issue are entitled to know from the Principles and Rules, and in advance of any FSA investigation or disciplinary action, whether or not their behaviour is or is likely to be in breach of such Principles or Rules (Articles 6 and 7 of the Convention).

- 6.11 As to the second category, if there is evidence of a breach of the Rules, it does not follow that it will be necessary or desirable or preferable to take disciplinary action based exclusively on a breach of the Principles other than the Rules, and insofar as the FSA suggest otherwise we do not agree (paragraph 91-95)
- 6.14 In relation to prudential regulation and discipline, except that we take the view that with breaches of prudential requirements the FSA should first seek to deal with them by way of using one or more of its wide range of powers rather than and before taking any disciplinary action, we have no comment on paragraphs 96-101.
- 6.13 The FSA's system (paragraphs 102-109) for the imposition *by it* of fines, in amounts to be decided *by it*, and which become *its* assets and are to be used *by it* to pay *its* costs, on Authorised Firms or Approved Persons is likely to be in breach of Article 6 of the Convention and creates a clear and obvious conflict of interest. The decision as to whether to fine, and how much the fine should be, and the amounts of costs a firm or person should pay to the FSA, needs to be made in a way which is, and is seen to be, in compliance with jurisprudence under the Convention (especially Article 6), and independent of the FSA in its role as investigator and prosecutor and potential beneficiary of any fines and costs. This will require ring-fencing the person/body/tribunal which decides on punishment from the investigator and prosecutor, and from the beneficiary of any fines or costs.
- 6.14 Further, to ensure compliance with Article 6 of the Convention, and so that the firm or person concerned is aware of the precise amount of each, the fine element and costs element of any financial penalty needs to be itemised separately and clearly, and the proportion each bears to the total financial penalty should be clearly discernible. The amount of the costs order should be determined only by the costs incurred by the FSA and what proportion of such costs it is reasonable to order the relevant person or firm to pay..
- 6.15 We agree with the FSA's policy in relation to the publicity to be given disciplinary cases (paragraph 113-114), the general policy being that after any appeal it will make public the imposition of disciplinary sanctions.

## **7 Section 6 - Market Misconduct**

- 7.1 Under the draft Bill, the FSA is to be given a range of enforcement powers aimed at combating market misconduct, including investigation powers, the power to bring criminal proceedings for offences of insider dealing and misleading statements and practices, the power to impose civil fines in cases of "market abuse", and the power to impose (itself) or to seek (from a civil court) restitutional orders in cases of market misconduct.
- 7.2 The FSA's power to bring criminal proceedings will be shared with other prosecuting authorities, and is intended to be exercised in accordance with the Code for Crown Prosecutors (applying, in particular, the "evidential test" and "public interest test") (paragraphs 117-124). We have no comment to make on this.
- 7.3 The new civil fines regime for market abuse cases is intended by the FSA to complement (not replace) the existing criminal regime for insider dealing and market manipulation. In cases where the FSA considers that it is not appropriate for it to commence criminal proceedings or to refer possible offences to another prosecuting authority, the FSA will consider whether the case is appropriate for the exercise of any of its civil enforcement powers.
- 7.4 The FSA intends to adopt a general policy that it will not seek to impose a civil fine for market abuse against a person who has been or is to be the subject of a criminal prosecution which involved consideration of substantially the same allegations of fact (paragraphs 126-127). It

will, of course, be open to the FSA, wherever appropriate, to take other action in such cases, such as civil action to obtain a restitution order, or to take intervention action, or to withdraw authorisation or approval. Before taking any civil action, the FSA would carefully consider whether civil action might unfairly prejudice the criminal prosecution or the defendants to such criminal proceedings, and whether it was appropriate to take civil action having regard to the criminal proceedings and the powers available to criminal courts. Except that we believe it would generally be oppressive and inappropriate to impose a civil fine on a person who had either been acquitted in criminal proceedings or against whom such proceedings had been discontinued, we have no comment to make on paragraphs 125-129.

- 7.6 In determining whether to exercise its powers to impose a civil fine, the FSA will take account of whether the relevant conduct involves a breach of the Code of Market Conduct issued by it and the definition of abuse in Clause 56 of the Bill, and will also take account of the nature and seriousness of the misconduct in question, the conduct of the person concerned, and any other relevant factors. Except that, as we have said, the definition of market abuse should be “fault-based”, we have no comment to make on this approach (paragraphs 135-142).
- 7.7 When deciding the level of a civil fine for market abuse, the FSA will take account of all relevant matters including the nature and seriousness of the abuse, the profits accrued or loss avoided, the circumstances of the person concerned, and the FSA’s costs. Except that our comments (paragraphs 6.13-6.14 above) on the need to separate the fine element and the cost element of any financial penalty and the need to ensure compliance with the Convention apply equally here, we have no comment on the FSA’s approach (paragraphs 145-149) to determining the amount of the financial penalty for market abuse.
- 7.8 The important remedy of restitution will be available not only on application by the FSA to a civil court, but also to any criminal court dealing with an insider dealing or misleading statements and practices case, and to the FSA itself (without an application to a court) where a person has engaged in market abuse. We have no comment to make on the FSA’s approach to the use of its powers to seek or require in cases of market misconduct (paragraphs 150-161).
- 7.9 Except that, wherever possible and appropriate, all issues arising out of misconduct should be dealt with in the same forum and, if possible, at the same time, we have no comment to make on the FSA’s approach to determining when it should exercise its discretion to apply to a court for the imposition of a civil fine or requirement to make restitution rather than exercising its own powers to punish such behaviour (paragraphs 162-167)

## **8 The FSA’s Decision-making Process**

- 8.1 If the FSA considers that an authorised person has contravened a requirement imposed on him by or under the Act (at present, the Bill), it may require him to pay a penalty in respect of that contravention (Clause 136 of the Bill), or publicly censure him (Clause 135). This general power given to the FSA to fine or issue a public censure is, accordingly, exercisable not only for a contravention of the Act (at present, the Bill), but also of any FSA Rules. In addition, the FSA will have power to intervene, withdraw authorisation, impose civil fines for market abuse and require payment of restitution. Although the FSA regards decisions made by it under these powers as “administrative” (paragraphs 169 and 208), in fact these are also penal disciplinary powers involving decisions (by the FSA) not only as to investigation, but also as to adjudication and discipline/punishment by the FSA. The failure to appreciate this important distinction is, at least in part, the genesis for the problems we identify below.
- 8.2 The proposed statutory framework for disciplinary action by the FSA will require it, once it has decided to take such action, to issue a “Warning Notice” setting out the reasons for the proposed action. The FSA intends also to include in the Warning Notice its preliminary

findings of fact. In a case where a fine is intended, the notice must state the penalty that is proposed. Similarly, where a public censure is intended, the terms of the proposed statement must be set out in the notice. In either case, the FSA must specify in the notice of a period of not less than 28 days during which the person the subject of the notice may make representations to the FSA. Having considered any representations, the FSA must then, within a reasonable time, decide whether to carry out the proposed action. A decision to proceed with the proposed action must be contained in a "Decision Notice" issued by the FSA. The notice must set out the decision and the date on which it will take effect. If that notice is not appealed, the FSA may publicise the Decision Notice.

- 8.3 The FSA presently intends (paragraph 178) that the exercise of its "administrative enforcement powers", ie including its disciplinary/punishment powers, will follow a detailed responsible for making an initial assessment as to whether the exercise of the FSA's administrative enforcement powers is appropriate. However, in cases where the imposition of significant sanctions on the basis of serious allegations of misconduct is "in view", such cases will be considered by an Enforcement Committee (the "Committee") (established by the FSA Board). The Chairman of such a Committee would be appointed by the FSA Board. The membership of the Committee will include practitioner and public interest representatives. On behalf of the Board, the Committee would take decisions on the exercise of the FSA's disciplinary/punishment powers. The FSA intends the Committee Chairman to be involved in the development of regulatory policy within the FSA, and that he/she might participate in discussions of relevant Board Committees concerning the review and development of the FSA's regulatory policies, particularly its enforcement policy. Further, the FSA believes that the FSA's Enforcement Division staff, who will have relevant knowledge and experience, should be involved in the decision making process, and that the initial recommendation for the exercise of the FSA's disciplinary/punishment powers should come from the operational staff (paragraph 196). In cases of particular seriousness or difficulty, the staff would seek guidance from members of the FSA Board and, in very serious, high profile or complex cases, the decision to recommend disciplinary action may be referred to the Authorisation and Enforcement Oversight Committee of the Board. The FSA's current thinking is that any proposed decision to impose a "disciplinary sanction" (which phrase we assume includes fines and public censure), or to impose a restitution order, or to impose civil fines for market abuse, should be referred to the (Enforcement) Committee (paragraph 197).
- 8.4 In all cases referred to the Committee, it would first consider and decide whether a Warning Notice should be issued by the FSA on the basis of the recommendation submitted by the staff. If it was decided to issued such a notice, and it was issued and sent, and no response was received, or the response received revealed no substantial dispute as to the action proposed by the FSA, the Committee Chairman could proceed to issue a Decision Notice on behalf of the FSA. If a response was received indicating that there was no substantial dispute as to the facts or law, but that the person concerned considered that the proposed FSA action was inappropriate or excessive, the Committee Chairman would consider the response with the other members of the Committee which had initially considered the case. The person concerned could make oral representations to the Committee, which would then consider whether a Decision Notice should be issued by the FSA and, if so, on what terms. If the response revealed a substantial dispute of material fact or law, the Committee Chairman would consider what further enquiries were needed to resolve the issues. Where necessary, the Chairman could nominate two or more persons from the practitioner/public interest representative panel of the Committee with relevant expertise to consider the case in greater depth. If requested, the Committee would then hear oral representations on the case before determining whether to proceed with the proposed disciplinary action.
- 8.5 In all disputed cases, the individual or firm concerned would be entitled (at their request) to see the evidence upon which the FSA relies in support of the findings of fact set out in the Warning Notice, and to make representations on that evidence. The FSA envisages that, where there is a dispute of fact, the Committee would generally consider the relevant evidence

in documentary form. However, in some circumstances it may be appropriate for the Committee Chairman, this is necessary in order for the FSA fairly to reach a decision as to whether its disciplinary powers should be exercised.

- 8.6 Decisions to withdraw authorisation would be dealt with by a similar process to the above. Decisions as to intervention action, however, where the firm does not agree to such action, will be taken by the Committee Chairman, and the FSA does not consider that it would be practicable or desirable for initial decisions to take intervention action to be referred to the Committee. In cases of urgency, the FSA would issue a Decision Notice (without having to issue a Warning Notice) and the firm would then have 28 days in which to make representations to the FSA, which would be considered by the Committee Chairman. In other less urgent cases, the Committee Chairman might consider the representations with other members of the Committee. The firm concerned would have the opportunity to make oral representations to the Committee Chairman or the Committee.
- 8.7 If a Decision Notice is appealed, the appeal is to an Appeal Tribunal (The Financial Services & Market Appeal Tribunal), which may consider not only the evidence which was available to the FSA, but also evidence which was not, and may hear new arguments, and may consider the grounds on which the FSA based its decision and consider the action taken by the FSA in relation to the disputed decision. The Tribunal may then confirm, vary or set aside the decision. It may remit the matter to the FSA or it may impose, revoke or vary a fine or make any decision that the FSA could have made. The Appeal Tribunal will be independent of the FSA, and will be established and administered by the Lord Chancellor's Department as part of the Court Service. It will comprise persons drawn from a panel of legally qualified people and people with experience of the various financial sectors, all appointed by the Lord Chancellor. The Appeal Tribunal's procedures will be set out in rules made by the Lord Chancellor, and it will have power to compel the attendance of witnesses and take evidence under oath, and the power to award costs against the FSA or an appellant. None of the criticisms which we make below of the proposed disciplinary system apply to the Appeal Tribunal.
- 8.8 It will be seen from the above summary that the effect of the proposed system is that the FSA will investigate the conduct of the firm or person concerned, and will reach (preliminary) findings of fact, and itself decide whether an (regulatory) offence has been committed, and will decide on the appropriate punishment, although in certain serious cases *it (as prosecutor)* will have access to the Chairman of the (Enforcement) Committee and/or the Committee as to the FSA's own findings of fact and its decision on the proposed punishment, and as to the issue of a Warning Notice. The firm or person concerned would thereafter be free to make representations but this would be *to the same Chairman and Committee*, and the FSA would stand in the position of prosecutor and opposing party. A system which allows unilateral access to the "adjudicator" by the FSA (the prosecution) is flawed, and undermines the independence and impartiality of the "adjudicator" and the fairness of the system.
- 8.9 The FSA's proposed system fails to separate the FSA's investigative and prosecution functions from its adjudicative functions. It also undermines the independence and impartiality of the Chairman and Committee, by involving them not only in the adjudicative process but also in the prosecution process, and grants access at an early stage to one party only (the FSA) to the adjudicating tribunal (the Committee). This failure to separate the investigation and prosecution functions on the one hand from the adjudication functions on the other hand critically undermines the legality, fairness, independence, impartiality, effectiveness and creditability of the proposed system. Even allowing for the fact that it may be argued that any such defects are "cured" by the Appeal Tribunal system, such argument is not guaranteed of success, and there is a real and serious risk that the proposed system is or will be found to be in breach of Article 6 of the Convention as not being independent or impartial or fair (seem, by way of analogy, *Findlay v. UK (1997) 24 EHRR 221*; *Hood v. UK (1999) The Times, 11 March 1999 (Application No. 27267/95)*; and *Cable and Others v. UK (1999) The Times, 11 March 1999 (application No. 24436/94 etc)* and/or of the natural justice requirements of English law. The legal requirements of the Convention and or of the Human Rights Act 1998 (which has

received the Royal Assent and is likely to be in force by the end of 2000) do not appear to have been considered by those responsible for drafting the FSA's Consultation Paper or the relevant chapter, and no mention is made of either anywhere in the paper. Nor is the fundamental question of the conflict of interest created by the proposed system for the FSA (the conflict between its role as investigator and prosecutor on the one hand, and its role as adjudicator on the other) and for the Chairman/Committee (the conflict between the prosecution role on the one hand, and the adjudication role on the other hand) addressed anywhere in the paper, such failure being (at least an important part of) the genesis for the shortcomings identified by us in the proposed system.

- 8.10 The FSA says (paragraph 169) that it recognises that the powers given to it will place significant amount of power in its hands, and that the consequence for those subject to the FSA's decisions will sometimes be very significant indeed. "It is therefore important and to consider the procedural safeguards that should be put in place in relation to the exercise of these powers" (paragraph 169) and that, in relation to its decision making process, its aim has been to provide a process that is fair and seen to be fair, and efficient and effective (paragraphs 6 and 175). Regrettably, to the extent defined above by us, we are unable to say that it has achieved these objectives. Accordingly, and in answer to the question at the end of paragraph 269, we do not think that the proposed system will be effective in achieving the aim of being fair.
- 8.11 What is required is a separation of the adjudication function of the FSA from its investigation and prosecution functions. Further, the tribunal exercising adjudication functions should not have any investigation or prosecution functions, and it should be ring-fenced from the performance of such functions. The need is for fair and transparent procedures. An effective way of achieving this would be to use the current model of organisations like the SFA (investigation - staff recommendation - Executive Committee clearance - notice of disciplinary action - settlement discussions - (disputed cases to) independent first instance tribunal - appeal to Appeal Tribunal), thus providing a clear and independent and impartial two tier tribunal system (first instance and appeal). This system envisages four components - the FSA, the Enforcement Committee, a first instance tribunal and an Appeal Tribunal. The FSA's system envisages three components - the FSA, the Enforcement Committee and an Appeal Tribunal, but such a system is critically undermined by the FSA's proposal that the Executive Committee should not only perform the functions of an executive committee (in the way we have summarised above, and which includes liaising with and guiding the FSA) but also of a first instance tribunal adjudicating in disputed cases. As the FSA's proposed system already envisages disputed cases being the subject of adjudication at first instance (albeit by the Enforcement Committee), we do not believe that our proposal would aid significantly to costs.
- 8.12 We believe that, rather than a single Chairman of the Enforcement Committee, a panel of Chairmen will be needed, with experience in regulatory or disciplinary proceedings, and who should (wherever possible) be lawyers with relevant experience in the financial services, commercial or insolvency fields. We also believe that the practitioner and public representatives should be members of the Enforcement Committee, and should be voting members who are fully involved in its decision-making process. It goes without saying that the Chairmen and other members of our proposed first instance tribunal should not have any role in the FSA's investigations or prosecution or in the Enforcement Committee.
- 8.13 In relation to warning notices (paragraphs 199-200), we believe that these should contain the allegation, the alleged breaches of the legislation and/or the FSA's rules which are said to form the basis of the proposed action, the evidence said to support such allegations, the FSA's preliminary findings of fact, and details of the proposed action.
- 8.14 As to the proposal (paragraph 201-202) that there be a period of 28 days for initial written representations (subject to a discretion to extend such period in appropriate cases), we

believe that it should be made clear that 28 days is a minimum period for a response. We do not agree that 28 days should as a matter of routine be applied automatically to all cases.

Instead, particularly in serious or difficult cases, careful consideration should be given to what is a reasonable time for a response to be provided.

8.15 We welcome the proposal that provision will be made to enable a firm or person to enter into informal and without prejudice discussions with the FSA aimed at reaching agreement on the circumstances of the case and the action to be taken by the FSA (paragraph 202-203). We believe this will be a valuable opportunity for a sensible dialogue between the parties, and it should also not be limited to cases that are uncontested.

## 9 **Safeguards**

9.1 Under the Bill, the FSA is to be given very considerable and wide-ranging powers, the exercise of which will or may have very significant repercussions for firms and individuals. The FSA recognises that its powers should be “exercised in a manner that is transparent, proportionate and consistent”, and in a way “which ensures the fair treatment” of those the subject of such exercise of power (paragraph 6). “The consequences for anyone subject to the FSA’s decisions will sometimes be very significant indeed. It is therefore important to ensure that the FSA’s procedures contain appropriate safeguards” (paragraph 19). It also recognises and understands “the concerns that have been expressed about how (it will) exercise (such) powers” (paragraph 6).

9.2 We too are aware that serious concern has been expressed in some quarters as to the absence from the Bill of any check on any abuse of its powers or process by the FSA. However unlikely is such a scenario, we agree that it must be catered for. While judicial review and a declaration will be available as remedies for such abuse, and the Human Rights Act 1998 and, therefore, the Convention should apply to the FSA, as the powers being given to the FSA are so wide, the availability of these safeguards should not be left to chance. Accordingly, we believe that the Bill should spell out in clear terms, if only for the avoidance of doubt and to allay concerns, that all the above safeguards are to apply to the FSA and to the exercise by it or on its behalf of its powers.

## 10 **Conclusions**

10.1 Our primary conclusions are set out in paragraph 2 above.