Annex 2

FSMA TWO YEAR REVIEW: INVESTIGATIONS/ DISCIPLINE – ISSUES OF CONCERN

- Status/role of FSA's Principle 11 in a disciplinary context (particularly problematic when criminal action is possible - see below).

- Tensions where both regulatory and criminal action possible
  Allied to the point raised above is the difficulty that arises when, as is often the case during the early stages of an investigation, it is not clear whether the FSA intends to take regulatory or criminal action against a firm. In a criminal investigation, a party has the right to remain silent and to rely on the privilege against self-incrimination. Further, evidence obtained under the exercise of compulsory powers cannot be used against a defendant in subsequent criminal proceedings. This protection could be relied upon by a party under investigation if the FSA had compelled the production of information, but it may not be able to be relied upon if a firm had given voluntary disclosure under its Principle 11 obligations unless it is clear that the firm could argue that *in fact* – because of its regulatory obligations – it *had* been compelled to provide the information.

- Preliminary findings letters (PFLs)
  In theory these letters should only deal with factual points. However, in practice the law firms are finding that the FSA often produces 'hybrid' documents, setting out both factual statements and conclusions or setting out factual statements selectively – for example the documents often do not provide an objective assessment of the *totality* of the facts put before the investigators – or generally but in a way which is calculated to lead to a particular conclusion. This means they are difficult to respond to and, because the FSA does not go on to set out what consequences are likely to arise from the conclusions reached, it is not clear whether the party under investigation should be advised to take issue with those conclusions.

  The same point often arises even if the PFL does only set out factual points. It is difficult to know how to respond to a letter (and what factual information will be relevant in such a response) when it is unclear what will be alleged on the basis of the facts set out. For example, it is often unclear whether the facts set out in a PFL will lead to allegations of systems and controls breaches, negligence, or criminal activity. It is therefore very difficult to establish what factual evidence will be relevant in response. This problem would not arise if FSA's initial conclusions were separated from the account of the facts: the latter could then focus on providing an objective account of the events that have led to the case.

  In addition, firms are asked to comment on the facts but may not have all the evidence on which those facts are purportedly based – e.g. because the FSA has taken documentary or witness evidence from third parties which it is not *required* to disclose unless or until a warning notice is issued later on in the process. Clearly, strictly speaking, FSA is able to refuse to disclose this information at this early stage, on the basis that the disclosure obligation arises only later, but this plainly hampers the firm's ability sensibly to comment on the PFL and ultimately prevents the PFL from fulfilling its purposes of seeking to attain agreement as to the facts, so far as possible.

Overall, the role of the PFL needs to be clarified: PFLs should provide a self-contained objective account of the facts and a preliminary view of the likely consequences of the findings so as to avoid these problems.

In addition, it would be helpful to confirm the circumstances in which a party could ask the FSA to clarify the PFL.

It should be noted, in this context, that there are concerns that the RDC process can be too cumbersome. For example, reconvening the panel within a reasonable period of time can be extremely difficult given people's diary commitments. Steps to focus the issues at stake through improving the PFL procedures should help to reduce this difficulty.

- Other aspects of the RDC's procedures

  If firms are to have a fair opportunity of putting forward their case (which is their statutory right), then they must know precisely what the case is that they have to meet and this involves knowing what case the FSA has put forward to the RDC. There is a concern, however, that the emphasis on the administrative – rather than judicial – character of the process may have resulted in firms not being given the opportunity to respond to additional points made by FSA staff which have not been raised in the documents disclosed to the firm, or which result from the firm's representations. Currently, there is unease that firms may not have access to all the material which is before the RDC as a matter of course and that it can be necessary to do battle with the FSA in order to see this material.

- Limitation periods

  There is a limitation period for proceeding against individuals but not firms. We believe there should be a limitation period for proceeding against firms as well for two main reasons:

  (i) even if only the firm is pursued, individual employees may still suffer reputational damage; and
  (ii) the current discrepancy may lead the FSA to pursue a firm because it can no longer pursue the individual, when the individual is in fact the most appropriate target.

  Given our first concern, the protection afforded to the individual by the limitation period can be eroded *in practice* because there is no similar limitation period for firms. In addition, a limitation period for proceedings against firms may have some influence on the way FSA prioritises work on enforcement cases.

- Conclusion

  Overall, firms' perception of the RDC is important, and, in particular, it is essential that it does not appear to be a "rubber stamp" and that those who undergo the process come away with the impression that they have been fairly heard. Currently, however, it seems that there *can* be concerns about the fairness of the process and, even though these may not always be legitimate and may not do justice to the FSA/RDC, it would be unfortunate – and potentially damaging – if the steps that could be taken to reduce the concerns were not explored fully. It would be more unfortunate still if, in an attempt to reduce the time taken to reach decision notice stage, additional shortcuts to the RDC's consideration of a case were to be introduced.