THE FSA'S INVESTIGATIONS AND ENFORCEMENT REGIME

CHALLENGE IN THE TRIBUNAL

21 February 2012

DAVID MAYHEW

The role of the Tribunal

1. The Tribunal's function under the Financial Services and Markets Act 2000 is to:

> *"determine what (if any) is the appropriate action for the decision-maker* [i.e. the Financial services Authority] *to take in relation to the matter referred … to it"* (section 133(5)).

2. For the purposes of this paper, this function can be usefully contrasted with that of the Authority's Regulatory Decisions Committee (RDC): that body (constitutionally a committee of the Board of the Authority) is the decision-maker enabling the Authority to meet the requirement imposed by section 395(2) of the Act that certain decisions taken in the exercise of specific statutory powers are taken by someone who has not been involved in establishing the evidence on which the decision is based. In doing so, the RDC has conduct of the statutory process for the making of such decisions by the Authority – issuing a warning notice, providing the opportunity for, and consideration of, any representations and issuing a decision notice.

3. The referral of a matter to the Tribunal involves, in effect, the administrative decision-maker giving way to the judicial decision-maker:

> *"Once the formal process governing the making of decisions as released in the warning and decision notices has been completed and the relevant matter has been referred, that formal process gives way to the Tribunal's statutory 'determination' function and the Tribunal's rules of engagement take over. The Tribunal Rules reflect its different function and its different procedure, at least so far as concerns the evaluation of evidence. The prescribed steps in the process leading to the hearing, i.e. the reference notice, the statement of case and the reply, coupled with the rules of natural justice, are*

there to enable the Tribunal to determine what is the appropriate action in a fair and just manner."[1]

4. Proceedings before the Tribunal start afresh; it is neither a review nor an appeal process. This was an essential part of the legislative scheme of the 2000 Act necessary to comply with the fair trial requirements of Article 6 of the European Convention. [2] The allegations made in the decision notice and the circumstances on which they are based constitute "the matter referred". It is those which fall to be considered and evaluated by the Tribunal, not the decision itself.

5. There is, nonetheless, an expectation that the Authority will present much the same case to the Tribunal as was before the RDC[3]:

> *"As a matter of common sense and fairness we would generally expect FSA with the wide powers open to it, having taken time to evaluate matters, and having carefully reviewed and carried forward charges to the RDC, to bring much the same case when taken to this Tribunal. Of course important new evidence may unexpectedly come to light or there may be in other cases special circumstances which change that general expectation."*

6. Note, however, that while the decision notice delineates the matter referred, the Authority is not bound by the terms of the decision itself and can press for a different result provided the action falls under the same Part of the Act as the action proposed in the warning notice (sections 133A(1) and 388(2)). This may involve arguing for an increase in penalty or imposition of another sanction, as in the case of *Jabre* where the prosecution sought a prohibition order despite the RDC declining to make that order.

---

[1] *Jabre v FSA (Jurisdiction)* [2006] FSMT 035, at paragraph 28.
[2] By amendment in 2010 (Transfer of Tribunal Functions Order 2010), section 133 now applies to "a reference or appeal to the Tribunal". The latter relates to decision-makers other than the Authority, also added by amendment.
[3] *Legal & General Assurance Society v FSA* [2005] FSMT 015 at paragraph 15.

7. The logic behind this provision, apart from it being a *de novo* hearing rather than an appeal, is that the Tribunal performs a very different role in evaluating the evidence. It may receive any relevant evidence, whether or not it was available to the RDC at the time of its decision-making process (section 133(4)), and test that evidence using the traditional adjudicative techniques including cross-examination. Therefore, either side can contend that the correct decision is other than that made by the RDC.

Pleadings[4]

8. Although the respondent to the reference, the Authority is required to plead its statement of case in support of the referred action first, essentially taking on the role of prosecutor. In doing so it must:

- Identify the statutory provisions providing for the referred action;
- Set out the reasons for the referred action; and
- Set out all the matters and facts upon which the respondent relies to support the referred action.

9. In practice, the Authority typically translates the decision notice into the statement of case. The decision notice gives the Authority's reasons for the decision to take the action concerned e.g. to impose a penalty for misconduct under section 66.[5] Whether that suffices in terms of particularity for the purpose of the pleadings should be considered given (a) the allegations made in the decision notice and the circumstances on which they are based may not set out fully the case which the applicant has to meet; and (b) the flexibility allowed the Authority to contend for a different result and to introduce new evidence. There is also a real likelihood

[4] The Tribunal Rules are to be found in The Tribunal Procedure (Upper Tribunal) Rules 2008. Provisions for pleadings are set out in the specific procedure for financial services cases in Schedule 3: see paragraphs 4 and 5 which also contain the primary disclosure provisions.
[5] See section 388 for the formal requirements relating to decision notices.

that the Authority's understanding of its own case will continue to evolve as it prepares for a full adversarial hearing.[6]

10. The applicant's reply must:

- State the grounds on which the applicant relies in the reference;
- Identify all matters contained in the statement of case which are disputed; and
- State the applicant's reasons for disputing them.

11. The pleadings therefore seek to identify what is agreed and what is in dispute; the procedure is designed to ensure that the applicant knows the charges and that neither party is taken by surprise. But, this is in a disciplinary context: technical pleading points do not play well with the Tribunal.[7] Similarly, the proceedings may be adversarial, but the Tribunal does not simply adjudicate between two competing cases. Rather it steps into the regulatory process itself, determining what action the Authority should take in the circumstances.

12. Rarely should a question of jurisdiction arise on the pleadings: that is, does the Authority have the statutory power to take the action proposed? It did so, however, in a recent case for a financial penalty under section 66 where the Applicant contended that much of the alleged misconduct did not fall within the scope of carrying out his controlled function as required by Principle 1 of the Statements of Principle for Approved Persons (APER). The point was raised by the RDC at the warning notice stage, but the Authority maintained that jurisdiction under section 66 and APER extended to misconduct substantially connected to activity regulated by the controlled function. The point was not taken at the representations stage, but was argued before the Tribunal.[8] The Tribunal's decision on the point of law is awaited.

[6] That the case evolves through its investigation and administrative decision-making stages is obvious enough; but the decision notice should not be assumed to be the last word, particularly if expert evidence is required at the Tribunal stage.
[7] See, for example, *Legal & General Assurance*, at paragraph 17
[8] *Karpe v FSA* FIN/2010/0019 Hearing 12 to 20 December 2011. The Applicant acknowledged that there was jurisdiction to make the related prohibition order based on the same facts: there the test was one of whether

Proof

Burden of proof

13. It is axiomatic that the burden is on the Authority in enforcement cases to prove its case. So, if it maintains someone whom it has approved to perform a controlled function is no longer a fit and proper person to perform that function, it must prove that to be the case.[9]

Standard of proof

14. Again the position is clear: the civil standard of proof, on the balance of probability, applies.[10] Given the variety of matters which may come before the Tribunal and the potential seriousness of the consequences for the firm or individual concerned of an adverse finding, reference is often made to the cogency of evidence required to meet the standard. As it was put in the *Chhabra* case:

> *"… some things are inherently more likely than others and cogent evidence is generally required to satisfy a civil tribunal that a person has been fraudulent or behaved in a reprehensible manner. Generally speaking, people tend not to commit serious offences – not least because of the consequences likely to follow if they do – and someone with a good character is less likely to behave badly that someone with a bad character. Someone who values their reputation will be less likely to imperil it than someone known to be disreputable. The more inherently unlikely it is that something has happened the more persuasive the tribunal will need to find the evidence pointing that way before concluding it to be more likely than not."*

---

he was fit and proper to perform the controlled function; rather than whether he was performing that function at the relevant time.

[9] See, for example, *Hoodless and Blackwell v FSA* [2003] FSMT 007 at paragraph 20. By way of contrast, if someone is challenging a refusal to grant approval because the Authority is not satisfied the person is fit and proper, the legal burden is on the applicant to establish that *prima facie* he is a fit and proper person. The Authority then has the evidential burden of proving that on the evidence the Tribunal cannot be satisfied that the applicant is fit and proper. It does not have to prove that the applicant is not a fit and proper person: see *Thomas v FSA* [2004] FSMT 008 at paragraphs 99-102. In the recent approval case before the Upper Tribunal of *Sime v FSA* FS/2010/0040, Decision 10 January 2012, while the burden of proof was not discussed in terms, the approach was similar. But the Tribunal was troubled by the Authority's reliance on unproven allegations by third parties, particularly where the person had been previously approved by the Authority, and said, "*If on examination they are not substantiated, we should disregard them"* (paragraph 14).

[10] *Chhabra and Patel v FSA* [2009] FSMT 072 at paragraph 54; *Legal & General* at paragraph 19; and *Hoodless and Blackwell* at paragraph 21.

15. In that case allegations of market abuse were regarded as serious allegations. Given the overlap with the criminal law that is uncontroversial. So, too, cases involving allegations of dishonesty or fraud will demand cogent evidence. In other cases, the seriousness may be disputed. On analysis, this can be a complex equation, often involving (the applicant's subjective perceptions of) the likelihood and consequences of an adverse finding feeding back into the probability of risking such a consequence by engaging in the conduct in issue. That of course pre-supposes such risks form part of the applicant's thinking process at the time of the conduct in question; but then so does the enforcement theory of "credible deterrence". [11]

The evidence

16. The Authority's investigations typically generate a lot of paper. Its investigation report, often lengthy, and the material relied on in the report will form part of the papers put before the RDC. In turn that material, together with documents generated by the RDC process, including a transcript of the RDC "hearing", will be included in the trial bundles used at the substantive Tribunal hearing.

17. The challenge for the Authority is to balance the rigours of putting before the Tribunal the best evidence available against the practicalities of limited access to witnesses, while taking advantage of the Tribunal not being bound by the strict rules of evidence[12]. In particular, witnesses of fact may still be employed by the applicant firm, or otherwise reluctant to assist the prosecution of what appears to them to be ancient history involving former (or current) colleagues.

[11] Note in this regard the conclusion of the Law Lords that context is all when assessing the utility of this approach to the civil standard: neither the seriousness of the allegation nor the seriousness of the consequences should make any difference to the standard of proof; and inherent probabilities were simply to be taken into account where relevant in deciding where the truth lay: *In re B (Children)* [2008] UKHL 35 at 13-15 (per Lord Hoffmann) and 69-73 (per Baroness Hale of Richmond).
[12] See rule 15(2).

18. There is a natural tendency to rely heavily on contemporaneous documents, supplemented by reports generated after the events in question occurred (for example a skilled person's report under section 166) and what interviewees have said during the course of the investigation. Similarly, submissions or witness statements placed before the RDC may be used to contradict what is being said by, say, the applicant in evidence to the Tribunal. All of this material is, of course, filtered through the prosecution's theory of the case which has developed over time.

19. When challenging the Authority's case on the facts, there is no substitute for getting down to the detail of the evidence likely to be relied on at the hearing. This will have been trailed by the way the Authority has employed the material in its investigation report and before the RDC, for example in response to written representations. Particular care should be given to examining the context in which the evidence relied on arose, be it an email chain, a post-event report or an extract from a lengthy interview, to establish whether there is an alternative and ultimately more plausible interpretation to place upon it. In particular, the use made of the evidence must be free from the taint of hindsight when joining up the dots.

20. The aim is to have the Tribunal make a finding in similar terms to this recent decision:

> *"The Authority misjudged the facts of the case and misjudged [the Applicant]…. In fairness to the Authority we observe that in the period leading up to the Decision Notice [the Applicant] did not have representation which he had before us, and his case had been put forward in a manner which did not reveal its real strength."*[13]

21. The Tribunal Rules do not provide for specific interlocutory steps analogous to the Civil Procedure Rules covering such matters as further and better particulars, or admission of facts. But there is no impediment in practice to adopt such procedures as are reasonable in the circumstances.[14] Similarly, a sensible discussion with the Authority's legal team prior to the service of witness statements about whom it intends to call as its witnesses may help identify

[13] *Geddis v FSA* [2011] UKUT 344 (TCC) at paragraph 54.
[14] Rules 5 and 15(1) provide the Tribunal with full discretion over case management.

where there are likely to be challenges over, for example, the evidential quality of interview transcripts.

22. This last example has had recent judicial consideration in the context of proceedings challenging decisions of the competition regulator, the Office of Fair Trading, before the Competition Appeal Tribunal. The following extracts from two judgments illustrate the danger of relying on transcripts of interviews alone:

> *"The OFT's decision not to lodge witness statements in support of its case caused us some concern, as we made clear at the outset of the hearing of this appeal. The OFT was asking us to uphold a finding of infringement – for which it had imposed a fine of over £3 million – on the basis of a transcript of an interview with a person who was apparently not the person who had written the notes on the key contemporaneous document. [The OFT] argued that criticism of the OFT's approach to proving its case would be 'a complete triumph of form over substance' and that there was no real difference between the transcript we were shown and a witness statement setting out the same facts supported by a statement of truth.*
>
> *"… the OFT wrote to the Tribunal summarising its position and explaining how the transcripts had been prepared and checked for accuracy. This letter, however, misses the point. No one is suggesting that [the interviewee] was lying in his interview or that the transcript does not fully and properly record what he said. The significance of the failure to produce a witness statement is two-fold. First, [the interviewee] has not been pressed about any of his answers – his comments in the interview in 2007 appear to have been simply taken at face value throughout the investigation and this appeal. If, once the appeal had been lodged, the OFT had gone back to [the interviewee] to take a witness statement they may well have filled in many of the gaps that currently exist in the account of what happened. …*
>
> *"The second disadvantage of relying on an interview transcript is that [the interviewee's] evidence has not been tested by cross-examination, a process which might also have generated a better understanding of the strength of the case against [the Appellant]. We reject the OFT's suggestion, made both at the hearing and in their letter …, that because it was open to [the Appellant] to call [the interviewee] as a witness for the purposes of cross-examining him and they decided not to do so, that [the Appellant] is somehow restricted in the extent to which it can challenge what is recorded in the transcript of his interview. It is not the task of the Appellant to supplement the evidence relied on by the OFT. Similarly, we reject the suggestion that because the Tribunal did*

not exercise its powers on its own initiative to call [the interviewee], his 'evidence' is somehow immune from criticism."[15]

23. In the second case, as a postscript to its judgment, a differently constituted Tribunal said this[16]:

> *"… [D]ifficult and important questions arise in relation to the 'evidence' adduced by the OFT. We have already noted that the transcript of [the interviewee's] interview with the OFT does not appear to have been satisfactorily reviewed by and attested to by [the interviewee] … Certainly he has not endorsed the transcript with a statement of truth or even signed it.*
>
> *"More fundamentally, we have considerable doubts as to whether material contained in transcripts of interview – even if reviewed and attested – is a satisfactory means of evidencing alleged infringements in cases of this kind. It is one thing to use a transcript of interview as evidence of relevant admissions by the interviewee; it is quite another thing to attempt to use it as evidence against a third party. … A witness statement will set out the relevant facts, will be attested to by the witness by way of a statement of truth, and will enable the witness to be exposed to cross-examination should the accuracy and/or truth of those facts be disputed. This is not to say that relevant interview transcripts cannot or should not be put before the Tribunal in support of a witness statement. It is simply that they are not a substitute for it.*
>
> *"… Where crucial facts are disputed it may in certain cases, and depending upon what if any other evidence is available, be very difficult to resolve the issues in the absence of evidence from a witness who has been deposed in the ordinary way and whose assertions are available to be tested in cross-examination by those who dispute them. Where central issues of fact cannot be resolved, the outcome may have to turn on the burden of proof. It is therefore all the more important from the OFT's perspective that there should be probative evidence before the Tribunal. Thus, even if the OFT has not obtained witness statements in order to fortify its own decision-making process, once it has become clear that there is a material dispute as to the facts on which its decision was based, the OFT should consider to what extent such statements are necessary or desirable in order to support those facts in an appeal …"*

24. It remains to be seen whether the Upper Tribunal takes the same approach in the Authority's cases.[17]

---

[15] *Durkan Holdings Limited and Ors v Office of Fair Trading* [2011] CAT 6, at paragraphs 108-110.

[16] *AH Willis and Sons Limited v Office of Fair Trading* [2011] CAT 13, at paragraphs 66-68. Note in contrast in relation to the Appellant's evidence the Tribunal said, "*we attach some weight to a statement from a witness prepared to give oral evidence and to be cross-examined – even if that statement is no more than a general denial*" (at paragraph 64).

25. A brief word about expert evidence: it has its uses, but also its limitations. It may be helpful as opinion evidence of market practice and therefore regulatory standards. But there is the constant danger - common to civil proceedings generally - of the expert becoming the advocate, arguing the party's cause, while impermissibly expressing conclusions which are on analysis inferences of fact rather than opinion, and overreaching to usurp the role of the Tribunal. See, for example, the Tribunal's comments in the *Legal & General* case at paragraph 18.

The regulatory standards

26. The Authority is given the power to legislate for the standards of conduct expected of both authorised firms and approved persons, by way of rules or principles and guidance or codes of practice. The Handbook contains the product of that legislative process; a process which includes the requirement of public consultation. It should therefore be the starting point in any analysis of the relevant applicable regulatory standards.

27. Other Authority publications, such as '*Dear CEO*' letters, may be used as being indicative of the standards expected to be applied at the time of the events in question. While the Authority expects the industry to be aware, for example, of the key messages contained in speeches of senior Authority representatives, the exact status of such speeches in the context of tribunal proceedings is open to question.

28. In this context, it may be that another source of material reflecting contemporaneously the expected regulatory standards will be found in the interaction between the firm and its

[17] The issue came up in *Pottage v FSA* FS/2010/0033 where the Tribunal's Decision is pending (Hearing 14 November – 2 December 2011 and 3-6 January 2012).

supervisors. Depending on the circumstances, any close and continuous supervisory relationship would warrant forensic scrutiny.

29. Given that both business practices and regulatory standards are constantly evolving, there is always the possibility of enforcement proceedings being used to assert higher standards than those in play at the time of the events in question. The unfairness of retrospective application of standards is something the Authority has acknowledged from time to time.[18] The Tribunal should also be alert to this risk; and it should be common ground before the Tribunal that the evaluation of the firm or individual's conduct requires the application of standards contemporaneous with the events and not those which may exist at the time of the hearing. [19]

Publicity and proceedings before the Tribunal

30. The first decision of the new Financial Services and Markets Tribunal, in 2002, established that the principle of open justice would apply to its proceedings.[20] At the same time, the Tribunal recognised the risk of adverse publicity brought about by the "*possibility of the press reporting not succeeding in giving a balanced and accurate account of the proceedings at the main hearing.*" To offset the fact that the press would only report on the Authority's opening of its case, the Tribunal directed that "*there will be an opportunity for [the Applicant] to make a statement in rebuttal at some stage on day 1 of the hearing (and preferably in the morning)*" (paragraph 49).

31. This has become common practice, as has the parties providing copies of the written opening submissions to the press at the commencement of the hearing.

[18] See for example, the Policy Statement, High level standards for firms and individuals, June 2000, at paragraph 2.10; the 31 October 2006 speech by the then Authority Chairman, Callum McCarthy, Principles-based regulation – what does it mean for the industry?; and the Authority Board Report, The failure of the Royal Bank of Scotland, December 2011, at paragraph 40 of the Executive summary.
[19] See, for example, *Legal & General* at paragraph 20.
[20] *Eurolife Assurance Company Ltd v FSA* [2002] FSMT 001; reaffirmed in *Canada Inc. (formerly Swift Trade Inc.) and Beck v FSA* FS/2011/0017, Decision 2 August 2011, at paragraph14.

32. The practical impact in this context of the routine exercise of the recently acquired power to publish the decision notice if the matter is referred to the Tribunal has yet to be considered.[21] Potentially negative impact on the person's reputation will not normally impress the FSA if asked not to publish the decision notice; nor will a request for confidentiality when the matter is referred to the Tribunal. This is in line with the Tribunal's approach. It has refused, for example, applications to exclude details of the reference from the public register on the basis that, while publication of the particulars might embarrass the applicant and might cause clients to ask questions he would rather not answer, this does not amount to unfairness.[22]

33. If there is to be a challenge to publication of the decision notice, it must be pursued as soon as the decision to refer has been taken. That challenge should be by way of an application to the Tribunal under rule 14 for a direction prohibiting the disclosure and/or publication of the decision notice, rather than by way of judicial review of the Authority's decision to publish, at least in the first instance and on the assumption that the Authority will not pre-empt that application by publishing the notice in the meanwhile.[23]

34. Confidentiality as it affects third parties, on the other hand, is normally respected by the Authority. It routinely anonymises the facts and matters recited in its decision notices to

[21] See section 391 as amended which gives wide discretion to publish such information about the matter to which the decision notice relates as it considers appropriate. The Enforcement Guide at paragraph 6.8 states, "*The FSA … expects normally to publish a decision notice if the subject of enforcement action decides to refer the matter to the Tribunal".* If the reference is successful, a notice of discontinuance will also be published making it clear on the Authority's website that the decision notice no longer applies (EG paragraph 6.10C).
[22] *Sonaike v FSA* [2005] FSMT 019; and *Karpe and others v FSA*, FIN/2010/0019 (unpublished decision cited in *Canada Inc.*). The Rules allow such exclusion if the Upper Tribunal "*is satisfied that it is necessary to do so having regard in particular to any unfairness to the applicant or prejudice to the interests of consumers that might otherwise result*" (rule 3(3) of schedule 3).
[23] See *Canada Inc.* (cited at footnote 19 above); *R (S) v FSA* [2011] EWHC 1645 (Admin); and *R (Canada Inc.) v FSA* [2011] EWHC 2766 (Admin). Note that the Administrative Court is predisposed to defer to the Tribunal on such matters. First, it granted interim relief on condition that an application was made to the Upper Tribunal under rule 14. Following the disposal of that unsuccessful application, the Court said: "*The plain fact is that the Upper Tribunal has now delivered a reasoned judgment as to why there should be no prohibition on publication. Like [the Deputy Judge who granted the interim relief] I regard that body as eminently suited to determining questions of that type. I would take a great deal of persuasion that this court should now depart from that decision …*" (at paragraph 20).

protect third parties who might otherwise be concerned about the impact of the proceedings on their own reputations. If the third party cannot be protect in this way, and is prejudiced by the notice, then it too has the right to refer the matter to the Tribunal under section 393.[24]

35. The Tribunal also has the power under rule 14 to impose a reporting restriction in order to protect, for example, the identity of clients of the firm, whether the applicant or third party in the proceedings. This power was exercised for the first time in December 2011 in the *Karpe* case.[25]

36. As with all such applications, it is sensible to alert the Authority to the intention to apply in advance of the hearing to avoid any unnecessary slip up which might render the application otiose. So, for example, in relation to reporting restrictions to protect the identity of clients, any copies of written submissions which might be provided to the press should take into account the proposed application by removing names which might otherwise be included as part of the narrative or the description of the documentary evidence.

37. Under ECHR principles, it may also be possible to persuade the Tribunal to sit *in camera* to deal with a discreet aspect of the proceedings if so justified in the public interest.[26]

38. A related subject is the issue of public access to court documents: pleadings, written submissions, witness statements, daily transcripts and documents referred to in any of these. This is uncharted territory: the Rules do not provided for it; but the principle of open justice suggests that access may be appropriate. The obvious starting point is the daily transcript – a

[24] The Upper Tribunal Rules also allow for the third party to apply to be added to proceedings commenced by the main subject of the action as an "interested party" (under rule 9).
[25] *Karpe v FSA*, FIN/2010/0019 Hearing 12 to 20 December 2011. The order was unopposed and therefore no reasoned decision published. The terms of the order were varied to exclude clients whose identities as such were already in the public domain through press reports in India. See rule 14(1)(b) derived from Schedule 5 to the Tribunals, Courts and Enforcement Act 2007, paragraph 11(2)
[26] See *Diennet v France* (1996) 21 EHRR 554 at paragraph 34.

record of what has taken place in open court. There is the technical difficulty that it is the property of the parties, not the Tribunal, with a copy being made available to the Tribunal both as a courtesy and to aid the practicalities of managing the hearing. Pleadings, witness statements and written submissions, on the other hand, have been filed with the Tribunal. The Tribunal could direct that the public have access to them by analogy with the process in the High Court. How far that analogy runs is open to debate given the disciplinary (and regulatory) context.

Public law context

39. This question of context plays out more fundamentally in how the Authority, as a public body, exercising statutory powers conducts the proceedings. It should keep upper most in mind that it is not merely a civil litigant in adversarial proceedings, but rather in effect a public prosecutor. In carrying out its enforcement function in the public interest, the Authority is under a duty to act fairly. That duty must extend to ensuring that the Tribunal is aware of all relevant evidence, and not just that which suits the prosecutor's case theory.

21 February 2012

David Mayhew
39 Essex Street
London
WC2R 3AT