The City of London Law Society
4 College Hill
London
EC2R 2RB

Kate Higginson
Enforcement Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Victoria Raffé
Strategy & Risk Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

4 September 2008

Dear Sirs

Response to CP 08/10 and DP08/3

The City of London Law Society is the local Law Society of the City of London and represents City solicitors, who make up 15% of the profession in England and Wales. Members of the Regulatory Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisors, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure provides such as the operators of trading, clearing and settlement systems.

We are writing to respond on the following issue raised in the consultation and discussion paper.

We accept that the FSA has made considerable efforts to understand and set out the difficult and conflicting issues involved in the move to greater transparency. We also think that it is best to accept that greater transparency will come. We understand the nature of the competing pressures on the FSA and they are well explained in the Discussion Paper. However, in our view it is important not to sacrifice fairness or due process, and in this context we have serious concerns about the proposals in relation to OIVoPs as set out in CP08/10 and DP08/3. The focus should be on trying to ensure that transparency does not manifest itself in an arbitrary and capricious manner, especially where the danger of undermining the enforcement process is concerned.

We would summarise our key concerns as follows:

1. In our view it is clear that the power to vary permission is intended to recalibrate the boundaries of what an authorised person can do. The reference in Section 45 of FSMA to 'protecting the interests of consumers or potential consumers' must be read in this light, i.e. as referring to the consumers who may be adversely affected by the activities of the authorised person concerned. We cannot see any warrant for the view that an OIVoP can be made solely or mainly for the purpose of "naming and shaming" the firm in order to provide a message to others.

2. The FSMA was specifically, and advisedly, framed to ensure that publicity about a firm's alleged shortcomings is restricted until the matter has been subject to due enforcement process. The FSA's proposals cut across the important principle that this involves.

3. Even if the FSA's approach were permissible, we cannot see that it is necessary or desirable. The FSA can inform the industry and consumers about its concerns without naming names. Indeed, a well-presented explanation of the FSA's general approach to issues (which the FSA already provides, e.g., in relation to financial promotions) is likely to be more useful and 'transparent' than requiring firms to make what they can of individual supervision notices.

4. We note that the FSA regards the publication of confidential information in this context as permissible under the "gateway" for disclosure "for the purpose of enabling or assisting the discharge of a public function". For the reasons mentioned above we doubt whether it is part of the FSA's "public function" to name names without due process. Even if it were, we believe that the FSA should be circumspect in the use of this gateway. It is an exception to an important and unequivocal rule, and we believe it should be applied narrowly. The extent to which information provided to the FSA remains confidential is a recurring concern of firms, and we do not believe that 'transparency' in the relationship between firms and the FSA will be improved if the FSA is over-ready to publicise their affairs.

OIVoPs and the FSMA

The power to make an OIVoP under section 45 of FSMA is limited in its scope. It may only be exercised if it appears to the FSA that:

"in relation to an authorised person"

- he is failing or is likely to fail to satisfy the threshold conditions;

- he has failed during a period of at least 12 months to carry on a regulated activity for which he has a Part IV permission; or

- it is desirable to exercise that power in order to protect the interests of consumers or potential consumers.

In the examples given by the FSA for the increased use of the own initiative power, it is clear that neither of the first two options is applicable. It is not at all clear that the examples given by the FSA satisfy the requirement that the exercise of the own initiative power is desirable in order to protect the interests of consumers. In construing this section it needs to be borne in mind that it is directed at conferring a power on the FSA which affects the position and

permission of a particular authorised person. When construing section 45(1)(c) it is clear to us that it was intended to refer to those consumers who may be affected by the activities of the authorised person, not consumers in a more general sense. We do not think it is legitimate under section 45 to use the OIVoP on the basis that it may affect the way other firms deal with their clients.

OIVoPs as an enforcement tool

The FSA proposes to impose OIVoPs in both a supervisory and an enforcement context "even in circumstances where the firm is itself prepared to take action". The FSA states that this change will "allow it to have a more immediate and effective impact on firms by imposing conditions on a firm's activity going forward that will help reduce the risk of detriment to consumers". If a firm is itself prepared to take action, then the imposition of the OIVoP makes no difference at all. It is difficult to see how, in many if not most cases, it remains "desirable to exercise that power in order to protect the interest of consumers or potential consumers" and therefore what statutory vires there is for the exercise of the power where the firm itself volunteers remedial steps. If the FSA thinks otherwise, then it owes the industry robust objective criteria against which a proposal must be assessed; additionally there should be a presumption against the exercise of the power where a firm is willing in good faith to act.

The amendments proposed to, for example, section 8 of the Enforcement Guide seem to us to be significant and we are not convinced that they are a proper use of the FSA's OIVoP powers. The FSA is now stating that it may use an OIVoP not only as part of supervisional monitoring but also "as part of an enforcement action". We assume that this means that FSA has initiated or proposes imminently to initiate formal enforcement proceedings and the OIVoP can be viewed as a sort of interim injunction. However, the publication of an OIVoP in these circumstances would also amount to interim publicity to the enforcement action before its conclusion, which is expressly prohibited under section 391 FSMA. The proposal to publish OIVoPs in the context of an enforcement action appears therefore to run a very high risk of being unlawful.

We assume that any reference to OIVoPs being used as an enforcement tool is not to be taken as meaning that this power will be used instead of the formally prescribed enforcement procedures as this would not be permissible under FSMA. The FSA states the purpose of publication is to "deter" other firms, inherent in the language of "deter" is that the publication of the OIVoP, with the reasons why it was imposed, would also penalise, by making an example of, the firm concerned. The fact that the OIVoP process only provides for an ex-post facto appeal, rather than prior due process as in the case of the disciplinary powers, clearly evidences that Parliament intended it as a provision for the protection of the firm's clients when it was necessary to take immediate action, and not as a form of penalty.

Public censure

The FSA states that it is considering developing a fast-track enforcement procedure for public censure cases. It states that there would be due process but there would be a more limited, streamlined and faster investigation. It is not clear to us how the FSA intends such a procedure to operate and also to provide due process. For example, is the FSA saying that it could decide that there was a clear breach of financial promotion rules and therefore in some way restrict the rights of the firm to provide evidence, make representations, etc.? Due

process is merely a formality if the FSA has made up its mind up that there has been a rule breach. This seems to us to be the very opposite of due process. Much more clarity is needed on what is meant by "streamlined" in this case.

OIVoP as a public censure

The FSA has not been clear as to the circumstances in which it considers that it may use the OIVoP in the new regime. It is little comfort that it does not propose to use it "on every occasion we make a request or raise a concern". This rather suggests that the threshold for determining its use will be rather low. In particular, as noted above, we do not think that it is legitimate and justifiable to use an OIVoP to communicate the nature of concerns about particular conduct more widely. At some points the FSA seems to accept that it has to follow due process before it can publish a statement that amounts to public censure of an authorised person. We suggest that if the FSA is to use the OIVoP in the wider circumstances that it suggests and were to publicise this use, the FSA will be implying that the firm is in breach of FSA requirements, and it will certainly be perceived as making such a statement.

The FSA Code of Practice states that the FSA will not disclose information which would amount to public censure without prior due process. We believe that the proposals on OIVoPs amount in some cases to the use of an OIVoP for public censure. Although as lawyers we accept that "public censure" in its Section 205 sense relates to a finding that a firm is indeed in contravention of a FSMA requirement, the proposed publication of OIVoPs in a greater number of cases certainly will be seen, and is presumably intended by the FSA to be seen, as a form of "naming and shaming". This gives rise to two very serious concerns:

- It risks setting up a parallel enforcement procedure not subject to the due process and safeguards contained in FSMA. FSA itself comments in para. 4.15 of DP08/3:

  > "it follows that calls by some for us to "name and shame" firms as a matter of course is not the approach envisioned by Parliament and is not one we can readily meet under FSMA ..."

  How can FSA demonstrate that there is a clear boundary in reality (as opposed to legal technicality) between publicised OIVoPs and section 205 public censure? It has not so far tried to do so and we doubt whether it can do so successfully.

- FSA has clearly recognised the problem of firms' being far more defensive and reticent in their dealings with FSA if there is the danger of information they volunteer being used for more enforcement action or for more adverse publicity. FSA does not sufficiently discuss this issue in the context of publicised OIVoPs. To paraphrase para. 41.6 of the DP:

  > "... in a world where every element of supervisory discussion or fact finding became from the outset a potential element in a [publicised OIVoP], there would inevitably be more caution in firms' disclosures to us, and more legal representation on their side and ours".

This is admitted to be a bad thing. and we agree

The OIVoP is not part of the disciplinary processes laid down by FSMA. Under section 53

FSMA, the FSA has the power to vary a Part IV permission with immediate effect. The procedure in relation to OIVoPs is therefore significantly different to that available in the enforcement process provided for in the legislation. A firm whose permission is varied with immediate effect may then have the opportunity to make representations or refer a matter to the tribunal, but by definition the matter is by then public. This is in complete contrast to the position where the FSA proposes a public censure where a proper period of notice, representation and appeal is provided for before any matter is public. The bizarre and unjust result of a wider use of and publicity for the OIVoP power is to give fewer rights and greater publicity to a firm which has not in fact been found of breach of any rule through the enforcement process, when compared with the position of a firm which has been in serious breach of a range of rules. The consultation makes no reference to what would happen if, following a subsequent appeal, the variation of permission or some of its grounds are withdrawn. Presumably the FSA would have to withdraw the relevant press notice on the website but it does not state what it will put in its place, and whether it intends to assist the firm concerned to retrieve its reputation. While it may be justifiable to take a robust view with respect to losses caused to a firm where the FSA feels in good faith it has to take action immediately to protect a firm's clients, even if it turns out that it was based on a mistake or was not actually justified, the situation is different when a firm loses out from publicity and immediate action, when other alternatives (e.g. agreement to change practices) which would not cause loss to the firm, were available to the regulator.

The FSA states that publicising a non-fundamental OIVoP would provide clarity to the firm and wider industry on the standards the FSA requires. Publicising the OIVoP brings no greater clarity to the firm than any private discussion that it has with the FSA. A purpose of publication in the manner proposed, by referring to the firm in a particular context, is clearly to publicise a perceived failing of the firm on a particular matter to the wider industry. It is difficult to see how this is not a public censure.

We therefore consider that publishing non-fundamental OIVoPs, particularly in the light of the reasons given for this change of practice, means that the OIVoP may be used as an alternative to and is intended to have a similar effect to a public censure. Parliament specifically provided for the FSA's disciplinary powers to include the possibility of public censure. The Financial Services and Markets Act 2000 ("FSMA") provides a proper process prior to the issuing of a public censure, which includes warning notices, decision notices, rights of appeal and the possibility of a tribunal hearing. The use of a non-fundamental OIVoP, subject to a decision made by FSA staff under executive procedures and published immediately, seems to us to amount to a circumvention of the provisions in FSMA directed at the use of public censure as a regulatory tool. If the FSA wishes to make a public censure it should use the powers conferred on it to do so. We are not aware of any evidence that the enforcement process for public censure under the FSMA is lacking in some way or that there is any need for these proposed changes.

Nor do we agree that the publication of non-fundamental OIVoPs assists consumers in choosing products, staying informed of financial matters or in acquiring a better understanding of the regulatory process. It does not improve financially sound decision-making or indeed provide any meaningful information that could be interpreted by an intermediary.

Confidentiality

We note that in the CP and DP, FSA has radically changed its previous position on the question of the confidentiality of information received from firms. Except for MiFID cross-border regulatory information, it now appears that FSA is satisfied that the "gateway" permits public disclosure of confidential information provided that such disclosure "enables or assists [FSA] to perform its functions" including giving information and guidance.

We found the FSA's statement on the extent of its obligation of professional secrecy extremely concerning. The FSA's position seems to be that there are no restrictions on its use of confidential information received directly from firms. If this is the FSA's position then much wider publicity will need to be given to this, as we believe that firms would be extremely concerned to discover that the FSA did not consider that there were any restrictions on its ability to disclose confidential information. We are aware that the FSML City Liaison Group has raised serious concerns about the position which the FSA has taken in relation to the confidentiality of information provided by firms to the FSA, and in particular the implications that this may have in relation to requests made under the Freedom of Information Act. We share these concerns and think that the FSA's proposals have a potentially very serious impact on both the willingness of firms to share information, and indeed on the desirability of placing a financial services business in the UK.

If the FSA's view is correct as a matter of law, we believe that as a responsible regulator, the FSA must impose on itself some safeguards if it considers it is lawful to take such an approach. Para. 4.6 of the DP merely contains the weak observations that the disclosure must be able to be reasonably presumed to make a material contribution to the discharge of [a] function".

FSA should build on this recognition in its proposed Code of Practice, by setting stringent criteria for assessing whether a disclosure "enables" or "assists" a function. We do not consider that the draft Code achieves this because it does not sufficiently direct attention to the position of the particular firm whose confidence is proposed to be breached. This intent should be explicitly put in the scales.

However, the FSA should be in no doubt about the deep level of concern we feel about the legitimacy and practicality of its interpretation.

The thought that the FSA (however unlikely it would do so in practice) would regard itself as able to publicise confidential information wherever it considers it would help to meet its objects or appear to be otherwise desirable (para 4.5 of the DP) would horrify our clients and particularly overseas clients.

Conclusions

The FSA seems to have decided that it will use a power conferred on it, we believe, for limited purposes, more widely, and in particular use that power to, in the FSA's words, "communicate more widely the nature of its concerns". We do not think this is a legitimate use of an OIVoP, nor do we think it would be particularly effective. The FSA has many options available to it to publicise the nature of its concerns about particular conduct, indeed as we have raised before, one of the difficulties which firms have in identifying the FSA's position or concerns on various matters, is not assisted by the poor search and navigation functions available on the FSA website. We think it unlikely in the extreme that the use of an OIVoP power in the circumstances described would achieve the degree of publicity or effect

that the FSA seems to think it might have on the behaviour of third parties.

Apart from the fact that we have concerns about both the vires and the policy behind this proposal, we do not think it is in the interests of consumers or the FSA. We believe that it will increase the feeling amongst firms that a constructive dialogue with their supervisors is an unlikely outcome of raising or reporting particular issues. The prospect of adverse publicity for the firm in relation to what would formerly have been considered to be a supervisory matter, is likely in our view to deter dialogue rather than increase it. In addition, we note that no other regulator operates in this way and the FSA's proposals will certainly not make the UK a more attractive place in which to base a business. Firms do not expect to be made public examples in relation to supervisory issues, particularly where the firm concerned is willing and able to take the action that the FSA requires. In such circumstances, using the OIVoP procedure to send a message to the world at large is detrimental to the firm, does not improve the position of its clients and, would be in our view, an inappropriate use of the power.

Yours sincerely

pp. C. Cobbi

Margaret Chamberlain
Chair CLLS Regulatory Committee

Members of the CLLS:

Bridget Barker, Macfarlanes
Chris Bates, Clifford Chance
Peter Bevan, Linklaters
Patrick Buckingham, Herbert Smith
Dominic Clarke, Herbert Smith
John Crosthwait, Slaughter and May
Robert Finney, Denton Wilde Sapte
Ruth Fox, Slaughter and May
Jonathan Herbst, Norton Rose
Mark Kalderon, Freshfields Bruckhaus Deringer
Tamasin Little, S J Berwin
Simon Morris, CMS Cameron McKenna
Rob Moulton, Nabbaros
Bob Penn, Allen & Overy
James Perry, Ashurst
Peter Richards-Carpenter, Mayer Brown International
Richard Stones, Lovells