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Dear Sirs,

CP10/11: Implementing aspects of the Financial Services Act 2010

The City of London Law Society (CLLS) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

With thanks for agreeing to receive our submission after the deadline, we wish to respond to certain of the questions set out in CP10/11.

Q7 Do you have any comments about our proposed policy for the suspension power?

Insofar as the FSA would propose to use this power against authorised firms as a further measure in the range of enforcement measures available, we consider that it should be used sparingly and very much as a 'last resort', recognising the potentially very serious consequences that a suspension of business activities is likely to have for a firm.

The Committee is concerned that the FSA draft proposals do not reflect this principle. Indeed, the observation at paragraph 3.10 (repeated in the proposed new DEPP 6A.2.3G):

> *"Our proposed approach is to use the suspension power where we consider that the imposition of a suspension will be more effective and persuasive deterrent than the imposition of a financial penalty alone."*

raises a serious concern for firms because in practice in most cases a suspension order could be regarded as providing a superior deterrent to a fine. For this reason we believe the conditional "could" in the proposed new DEPP 6A.4.1G is therefore misleading, and ought to be replaced with "will generally".

Suspension is unpredictable and imprecise in its financial consequences (and therefore potentially unfair) and consequently is a sanction which cannot be applied impartially and proportionately. For the same reason it will be difficult for the FSA to judge whether the combination of a penalty and a suspension will be a proportionate enforcement response.

The financial impact and deterrent effect of a temporary suspension of particular business activities cannot be quantified in a way which would facilitate comparison with other penalty-setting calculations. This is in stark contrast, for example, to the FSA's recent approach in quantifying penalties for client money failings, which we understand to be reflecting principles that were formally introduced to DEPP in March of this year.

The proposed guidance at sub-paragraph (6) of DEPP 6A.2.3G appears, for this reason, to be making a false assumption: the suggestion being that a lesser financial hardship may be imposed by means of a suspension order than by means of an immediate financial penalty.

The Committee also wishes to note that the implication of the proposed sub-paragraph (5) of DEPP 6A.2.3G – namely that the FSA may consider exercising its suspension power "where the person's competitive position in the market has improved as a result of the breach" – is that the FSA considers that it might seek to regulate competition in the financial services sector; it would not be appropriate for the FSA to use an enforcement remedy provided for under FSMA to bring about a competition remedy.

Moreover, the Committee is concerned that:

- a suspension order could have unforeseen and potentially business-critical and counter-prudential consequences for some firms which in most cases will not be merited by the firm's conduct; for example:

    - the suspension of a major business division could leave a firm carrying significant but unsupported overheads, including specialist employees unable to be utilised elsewhere; and

    - the suspension of certain business activities could cause, directly or indirectly, a firm to breach existing contractual obligations to clients or counterparties (some of which obligations could be owed to non-UK persons and/or be governed by non-UK law) leaving the firm exposed to consequential financial 'penalties';

- suspension can be used more readily, and unfairly so, against smaller and recently-established businesses than against larger established business with diversified interests and a broad customer base; the former would expect to be more materially disadvantaged by a suspension order; and

- suspension may not easily, if at all, be used against a systemically important institution, whatever the apparent merits the punishment (the 'too big to suspend' problem); this problem is acknowledged implicitly in the proposed new DEPP 6A.3.2G(5).

The Committee accepts that there may be cases where a firm's conduct has been so serious that suspension, if only of a business division, is a proper response, especially where there has been widespread and possibly continuing customer detriment. It is evident that Parliament has intended for this to be the case. But we are strongly of the view that this power should not come to be exercised as a routine response even to obviously culpable cases, and we would welcome a more explicit acknowledgement of the severity of suspension as an enforcement tool in the FSA's DEPP guidance.

Q8 Do you have any comments about our proposed policy for the non-approved persons penalty power?

The FSA's commentary indicates that the FSA's current position is that the more senior the post concerned the greater the knowledge of the FSA regime that should be imputed to the individual concerned, and therefore the more likely the FSA will view any failure to obtain approval as a punishable failure by that individual.

The Committee considers that any such assumption would be wholly inappropriate for directors performing functions at the level of an unregulated parent, and particularly so in the case of those directors who are outside the UK.

Given the ambiguities around the scope of the CF00 function (addressed in our earlier responses and discussions in relation to CP10/3) we suggest that the FSA should acknowledge explicitly in its guidance that allowances will need to be made for CF00 function holders who are "reasonably ignorant" as to the requirement for approval, and particularly those who are outside the UK.

Indeed there should be a presumption of reasonable ignorance if the firm has not informed such a person about the need for approval and he or she is otherwise unfamiliar with the UK regulatory regime.

As a general matter, we think it reasonable for a senior executive employed by a financial institution to be entitled to rely upon that institution to exercise due care and diligence to ensure that all appropriate approvals and registrations are obtained for its staff. If this were not the case, almost every individual on every board would be expected to carry out due diligence on the law in each country in which his or her institution carries on business.

This principle applies with even greater force to "non-employees" of a firm caught by the enlarged scope of the CF00 regime.

Q10-Q12 Financial stability information – gathering power

The Committee acknowledges that the Financial Services Act 2010 has given the FSA a wide-ranging power in this area. However, the FSA should acknowledge that "financial stability" is a generic and imprecise concept and that consequently the scope of the potentially highly intrusive information-gathering power will be inherently uncertain.

Against that background, we feel that it is incumbent on the FSA to provide more detailed guidance on the likely conditions for its use, the categories of institutions likely to be affected and the sort of information that (at this stage) the FSA envisages is likely to be sought. Such guidance could usefully be addressed in particular to those firms which have until now been operating outside the scope of the FSA's core supervisory jurisdiction and which could consequently struggle to understand what might be required of them. Ultimately this should work to the advantage of the FSA as much as to the firms concerned.

We understand that events are unpredictable in this area, and that accordingly the FSA cannot give comprehensive guidance; but we suggest that it could go further in preparing institutions for some of the scenarios which can be reasonably foreseen.

The FSA should acknowledge that it also follows from the uncertain scope of the powers, and the unpredictability of events, that institutions (especially unregulated institutions) may have great practical difficulties in complying with requests, even more so in urgent cases, if they have not been primed to some extent for what may be required. Unregulated institutions cannot be expected to conduct their affairs, and arrange their records, in anticipation of the use of an uncertain power.

We would be delighted to discuss the above observations and suggestions with you. You may contact me on +44 (0)20 7295 3233 or by e-mail at margaret.chamberlain@traverssmith.com.

Yours faithfully

Margaret Chamberlain
Chair, CLLS Regulatory Law Committee

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