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By email: bob.ferguson@fca.org.uk

10 October 2014

Dear Mr. Ferguson,

**Retrospective application of regulatory rules: FCA call for examples (August 2014)**

The City of London Law Society ("**CLLS**") represents approximately 14,000 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 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the **"Committee"**). The Regulatory Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

**Preliminary comments**

In this response we provide a range of examples and thoughts on the retrospective application of rules by the FCA/FSA. There is no single example that we wish to highlight from this list, and accordingly we have not included below questions 1 and 2 from the FCA's call for examples.

**Q.3: What are your examples of retrospective application of rules by the FCA or FSA?**

We would like to raise the following examples:

- *Sales of PPI:* when PS 10/12 came out there were complaints that the FSA was applying a more onerous interpretation of the rules than it had at the time the relevant policies

were sold. Although the BBA lost the judicial review, the legal argument was on a different point, namely whether it was appropriate to rely on the principles when there were specific rules in place. The judge's decision does not therefore invalidate the argument that the FSA had "applied a more demanding standard or interpretation of the rules after the event", in the words of the consultation.

- *Capital at risk products:* in 2004, the FSA issued a factsheet (providing guidance on the risks of structured capital at risk products) which it intended should assist consumers by providing them with information about the products and highlighting the potential risks, and which would sit alongside an adviser's product recommendation and any product materials. That factsheet purported to identify "the main risks involved with capital-at-risk products", and did not identify counterparty risk. In October 2009, in "Quality of advice on structured investment products", the FSA criticised "the widespread failure of advisory firms to adequately disclose counterparty risk to customers". The FSA said it was taking into account "the degree of due diligence that would have been reasonable for firms and advisers to have undertaken at the time" without applying "the benefit of hindsight to (its) reviews". It is however very clear that the regulator had the failure of Lehman (which served raised the issue of counterparty risk globally in September 2008) front of mind in forming its judgments in 2009. Although we acknowledge that the FSA went on to propose a lesser standard of due diligence for pre-Lehman sales, the need for advisers to flag counterparty risk to customers (though not necessarily to distinguish between counterparties rated 'A' or above), was plainly not within the FSA's contemplation in 2004, and arguably not pre-Lehman.

- *Use of dealing commission to pay for research and other services*: the 2012 paper on conflicts of interest in asset management firms adopts a more demanding interpretation of the rules than had previously been the case. This interpretation suggested that widespread industry practices were contrary to the rules, even though the FSA was aware of such practices – for instance Hector Sants had expressly told an industry conference that he had no problem with corporate access, which was widely reported at the time. The fact that the regulator's interpretation of these rules has grown more stringent over time is show by the fact that the FCA has needed to introduce additional rules this year, which were positioned as "clarifying" the existing rules.

- Similar "clarifications" can be seen in other areas, including best execution where the FCA now proposes (in its thematic review) to introduce a "four-fold cumulative test" on the basis of guidance from the EC which is not expressed in those terms. This is said not to be a new rule but a statement of pre-existing requirements. On the mis-selling of interest rate hedging products, firms have been held to standards under the appropriateness rule which had not be prevalent or expected by the FSA at the time of the sales.

- *Market abuse:* the FCA has proposed taking enforcement action against an individual in relation to market abuse control failings. Amongst FCA's criticisms are that the firm involved did not have a specific script that must be used on all wall-crossings, and did not keep a single index of near misses (even though records of near misses were retained). Neither of these are current requirements under UK law or in FCA's rules. They are all proposed as part of the ESMA implementing measures relating to revisions to the Market Abuse Directive which does not come into force until July 2016.

**Q.4: Do you have any other feedback or suggestions in relation to the issue of retrospection?**

We have to acknowledge that in many of the cases noted above, poor practices existed in the market and it may well have been correct for the regulator to act. The general principles themselves exist for this reason. However, we should be wary of the argument that the end justifies the means: FCA ought not to be able to deflect attention from poor supervision or rule making by seeking to apply new standards retrospectively.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact either Peter Richards Carpenter by telephone on +44 (0) 20 3400 4178 or by email at peter.richards-carpenter@blplaw.com, or Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours sincerely

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