FCA
Practitioner Panel

THE FCA PRACTITIONER PANEL:

RESPONSE TO FSA CONSULTATION PAPER 13/8

'PUBLISHING INFORMATION ABOUT WARNING NOTICES'

14 June 2013

1. Introduction

The FCA Practitioner Panel (the 'Panel') has taken a keen interest in both the initial policy decision to introduce the powers in s.391(1)(c) of FSMA, and now how the FCA will make future use of such power to achieve its statutory objectives.

The Panel responded to the FSA's CP12/37 regarding the process for deciding whether to publish a statement regarding issuance of a warning notice, and offered at that time to provide further comments on the wider policy on the use of the power.

We have provided our detailed comments below.

2. Executive Summary:

- The Panel appreciates that the changes to FSMA means the FCA has to consider how to use this new power, but we disagree with its conclusion that it should be used as the norm, unless there is a specific reason not to. We propose that the power be used the other way round, as the exception rather than the rule;
- The Panel remain deeply concerned about the impact of the use of this new power in this way and do not believe it fits well with our understanding of the new FCA approach;
- In particular, we hope that the power will be unnecessary for RIEs, which act as co-regulators of the financial markets with the FCA;
- The FCA should consider what it intends to achieve by publishing and how it will help it achieve its statutory objectives;
- The Panel is worried both about individual firm/personal reputational damage, and broader damage to consumer trust in financial services;
- Early publication in this way may impact the dynamic of settlement discussions with firms, reducing cooperation on enforcement investigations;
- We generally support the guidance given on when it will certainly not be appropriate to publish statements, but the FCA must give more consideration to when publication would 'prejudice the interests of consumers';
- The wording of the statements, as well as discontinuation notices, must be carefully drafted to ensure they are fair, clear and not misleading to the consumer.

3. Panel response:

The use of the power in s.391(1)(c) is a significant departure from existing policy, whereby firms and individuals could be sure that the case against them would only be publicised after they have had a chance to defend themselves before the independent RDC. The Panel were pleased to see that the RDC chairman remains the final arbiter in the use of this power. The 14 days window for firms/individuals providing views on the appropriateness of the action to publish a warning notice statement was a welcome change from the 7 day window originally proposed – although, admittedly, still extremely short.

Fundamentally, although the Panel supports the FCA taking a strong stance on enforcement to provide credible deterrence, we question the need to use this specific power in most cases. It is unclear what it will add to benefit consumers or assist the FCA in achieving its statutory objectives (although noting that the power was introduced by Parliament, not the FCA).

a) Use of the power

Now that the power to issue statements on warning notices has been incorporated into law, it will remain a tool that the FCA may use to achieve its statutory objectives. We can understand where the FCA thinks its new power could provide some value (e.g., to warn consumers at an early stage about a boiler room scam), but can equally see significant harm being done to honest businesses if the allegations are not borne out in full in the enforcement process.

The policy that the FCA will normally publish a statement where a warning notice is issued, except in certain instances, must be reconsidered. We feel that its use should be the exception, rather than the rule. The FCA is reminded that it must have regard to its regulatory principles, including principle (1)(b) "the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction". A default decision to publish a warning notice statement, except in certain defined circumstance, does not adequately measure the burdens and benefits of publication (discussed further below).

The Panel can understand that the FCA may be concerned that too much discretion may leave the regulator open to legal challenge, including via judicial review – in which case, it would wish to always publish or never publish them to avoid this discretion. However, we feel that if the guidance is for publication in most enforcement cases, this instead is likely to lead to much greater legal challenge. As a judgement-based regulator, the FCA could face challenge on any decision it makes. It should be confident in its considered judgement of the circumstances, not shy away from making decisions simply because of the legal risk involved. Legal risk can be mitigated most effectively by applying sensible judgement on the use of this power in a proportionate manner.

b) Benefits of publication

As stated above, we can understand the circumstances where the FCA believes it will be beneficial to publicise some enforcement action against a firm or individual to protect consumers through giving early warning. Given that the FCA has this power, there must be some further reflection on how the FCA thinks the statements will be used by consumers and what action it imagines they will take as a result. The FCA may feel that a statement will stop further customers buying products / services from a provider to prevent further detriment. If this is the case, the FCA may need to be clearer in the statements what action it recommends individuals take. This also leaves open the question of what happens to existing clients which cannot exit their products already purchased or who may now find an illiquid market in the products they would wish to sell. The FCA will be aware that this situation has arisen before in the case of traded life

policy investments (TLPIs, or so-called 'death bonds'), which were banned for most retail investors in April 2012. There is the potential to cause unnecessary consumer detriment to the customers of firms caught by this power.

If the intention is to prevent future consumer detriment, we would suggest that the temporary product intervention powers provided to the FCA are a more suitable and direct power to utilise.

Where enforcement action is taken against an individual, there may be less justification for publication of a statement on the warning notice. If there is genuine concern about an individual, the FCA can simply require the person to be removed from client facing functions, including revoking their CF30 permission.

The Panel is in general supportive of initiatives to make the regulator more transparent; however, we continue to believe that transparency measures should only be used if they are used with clear intentions in mind (and after consideration of the consequences). The FCA must ask itself whether the proposed use of the power will in practice contribute to the protection of consumers and wider achievement of the statutory objectives.

We have providing separate comments to the FCA's discussion paper on Transparency.

c) Consequences - reputational damage

Many commentators have already raised with the FCA the concern that publication of a warning notice statement will cause reputation damage to the firm/individual concerned. This equally concerns the Panel. However, we agree with the proposed guidance which fairly recognises that reputational damage by itself should not always be enough to prevent publication if used with discretion and without a default position to publish.

In looking at the recent experience of the FSA's RDC, we understand that:

- Many of the allegations detailed in warning notices are not fully borne out during the RDC process and make it to the Final Decision Notice (i.e., many serious allegations are changed and toned down); and
- Some warning notices issued do not ever result in Financial Decision Notices because the regulator drops its case, or the RDC finds in favour of the firm. We understand that this has happened in approximately 1 in 20 cases in the last two years.

These points show why reputation damage is a key concern for the Panel and must be given sufficient consideration by the FCA in every case.

d) Consequences - trust in financial services

In the sorts of cases discussed above, the Panel is worried that the use of this power will further undermine trust in the industry, without justification. We know from the foreword to the FCA's 2013 risk outlook that the FCA sees competing consumer detriment from failings/misconduct in industry, but also from "the detriment to society of people not being able to get access to the right products". Although we agree that strong enforcement action is needed to address and deter

the first kind of detriment, we fear the publication of warning notice statements may create the second kind by damaging trust in financial services. As the FCA tries to navigate the path between them, there is need to use this power sparingly.

e) Impact on settlement discussions

In seeking to achieve the best outcomes in enforcement action, the FCA will continue the FSA policy of trying to reach early negotiated settlement with firms of allegations against them. These settlement negotiations may occur at any point during the enforcement and decision making process (up to an Appeal Tribunal decision), depending on the circumstances. There is a risk that early publication of warning notice will affect the willingness of firms to want to engage in settlement discussions after publication of the statement on the warning notice (i.e., if their full charges are going to be publicised in any case). Firms may also feel under pressure to settle early or risk being the subject of a warning notice statement, undermining trust between firms and the regulator. Firms may feel that this situation is unjust, and could reduce their inclination to want to assist in FCA investigations (particular at the earlier stages of investigation). Such a situation could potentially bring greater time and financial cost to FCA enforcement action.

f) Unfair to the person

If the FCA does intend to use the powers in the way proposed in its consultation paper, we feel that the considerations highlighted are broadly acceptable. If the consequences of publication are so dire that they could unnecessarily put firms out of business, create redundancies among innocent employees or damage the health of third parties, these factors must be considered.

g) Prejudicial to the interests of consumers

The consultation does not provide guidance on the circumstances where publication could prejudice the interests of consumers. As we discuss above, we feel that publication of these statements could create consumer detriment for the broader consumer base by undermining confidence in financial services in certain cases. For example, consumers being put off from purchasing products which are in their long-term economic interests. Further, there is a need to consider the impact on consumers who cannot take action (e.g., exit products), as a result of publication of a statement, and how the impact on a firm could financially harm consumers. We feel the FCA should seek further views on this, and must now consider and make clear what consumer interests it could envision being prejudiced as a result of publication.

h) Detrimental to the stability of the UK financial system

There is a clear, although very remote, danger of potentially damaging the reputation of a large financial institution, which in turn causes it to fail and creating stability problems in the wider financial system. It is important that if this is a likely situation, this factor is considered carefully, with close consultation with the PRA (where appropriate).

i) Use of the power for investment exchanges

We note that the power to publish statements is applicable to recognised investment exchanges (RIEs). As we commented in our response to FSA CP12/37, the FSA/FCA and the RIEs have historically worked successfully together to ensure that UK markets operate effectively and in accordance with both the FSA Handbook and FSMA rules, and the rules in the RIE rulebooks. This relationship was characterised by open communication, consultation and cooperation, which has been effective to date.

The Panel hopes that the FCA's relationship with the RIEs will continue to be collaborative, and that the use of new powers on warning notice statements will not be necessary for RIEs. If such statements are considered, particular consideration must be given to the impact on the stability of the system if trust in key market infrastructure is undermined.

j) Wording of the statements

If warning notice statements are used, we agree that sufficient detail must be given and that the statement must be accompanied by sufficient warning and explanation on its use. The form of wording should be reviewed to ensure that it is useful for its intended audience (consumers) and does not become unclear, sensationalist or overly legalistic. Such statements could usefully link to further information about the Enforcement / RDC processes, to allow consumers to understand. The tone of the communication should also ensure that consumers know that a firm / individual is considered innocent, until the point they may be shown to be guilty.

k) Discontinuation notices

For firms, also important will be the discontinuation notice / statement published if the action does not result in a final notice. Such statements should be heavily publicised and make absolutely clear that the allegations against the firm/individual turned out to be false (and not just, that the FCA's case was not proven). We would welcome the opportunity to review and provide comment on suggested wording of the discontinuation notices / statements.