

FSA Update

At the FSA last week: -

Upper Tribunal clears John Pottage of compliance oversight failings

In a detailed 71 page judgment, the Upper Tribunal has cleared John Pottage, the former Head of Wealth of UBS AG ("UBS"), of compliance oversight failings. The judgment, released on 24 April, confirmed that the FSA had been seeking to impose a fine of £100,000 on him in respect of alleged breaches of Principle 7 of its Statements of Principle for Approved Persons ("APER") when he held the CF3 (chief executive) and CF8 (apportionment and oversight) significant influence functions at UBS between September 2006 and July 2007. Specifically, the FSA argued that Mr Pottage had failed to take reasonable steps to ensure that the business for which he was responsible complied with regulatory requirements, as he had failed to conduct an adequate initial assessment in relation to levels of compliance, effectively question assurances received as to governance and risk management frameworks, carry out continuous monitoring or recognise deficiencies or implement a sufficiently comprehensive review of systems and controls soon enough.

The Upper Tribunal did not find any of these limbs of the FSA's case against Mr Pottage to be made out. Applying the test set out at APER 3.1.4G, it

found that his conduct was not "below that which would be reasonable in all the circumstances". It found that the steps he took to assess the design and operational effectiveness of governance and risk management frameworks, which included: -

- making key personnel changes;
- instituting a peer review;
- responding to identified issues by commencing investigations and changing the risk rating of particular areas of the business;
- changing training, monitoring and risk certification arrangements;
- increasing the number of risk-related communications; and
- adding risk as a standing item to the agenda at management committee meetings;

leading to the implementation by him of a comprehensive operational risk review, were reasonable.

The Tribunal held that the FSA's suggestion the he should have implemented a systematic overhaul of compliance and governance arrangements sooner than he did, went beyond the requirements of the significant influence functions which he occupied.

Although, in previous separate instances of enforcement action taken by the FSA, individuals in a number of smaller firms have accepted personal liability for systems and controls failings, the proceedings pursued against Mr Pottage have been the first occasion on which the FSA has sought to define the boundaries of the responsibilities of senior executives occupying significant influence functions in large firms. Individuals

occupying those functions will welcome the greater clarity which the decision brings as to what the FSA may reasonably expect of them.

http://www.tribunals.gov.uk/financeandtax/Documents/decisions/John_Pottage_v_FSA_decision.pdf

Upper Tribunal hears another reference on individual responsibility for firm's compliance failings

No sooner than determining one case concerning individuals' liability for systems and controls issues, the Upper Tribunal is concerned with another, albeit relating to a very

Key issues

- Upper Tribunal clears John Pottage of compliance oversight failings
- Upper Tribunal hears another reference on individual responsibility for firm's compliance failings
- FSA imposes first fine for Listing Rule systems and controls breaches
- Administrative Court rejects challenge to Keydata action
- FSA confirms intention to ban "death bonds"
- FSA contacts over 76,000 potential victims of fraud
- Hector Sants advocates "constructive tension" between regulators and firms

different type of firm.

The Upper Tribunal has (on 25 and 26 April) heard a reference made by **Stuart Unwin**, who is challenging a decision notice issued to him by the FSA on 2 March 2011. The FSA has proposed to ban Mr Unwin from performing any significant influence function.

The FSA argues in its decision notice that Mr Unwin failed, whilst occupying the CF1 (director), CF8 (apportionment and oversight) and CF10 (compliance oversight) significant influence functions, to ensure the adequacy of systems and controls in relation to occupational pension transfers, the suitability of advice provided to customers or the effective monitoring of advisers and trainee advisers. It also suggests that he delegated tasks in some of these areas to an individual who he knew lacked experience.

Prior to the decision taken by the Tribunal in respect of Mr Pottage, previous cases where action has been taken by the FSA against individuals occupying significant influence functions in smaller firms in respect of firms' systems and controls failings have ended with fines and/or bans for those individuals. See, for example, summaries of previous action taken against Martin Lafrance and Sandradee Joseph in previous editions of *FSA Update* (26 March 2012 and 28 November 2011 respectively).

The Tribunal's determination in Mr Unwin's case is awaited. The questions facing the Tribunal in Mr Pottage's case related to very different facts. Nonetheless, individuals occupying significant influence functions in smaller firms (including some whose cases are due for consideration by the Tribunal later

this year) will watch with interest whether the decision taken in that case has any impact on its interpretation of the personal liability which they may incur for compliance failings by their firms.

http://www.fsa.gov.uk/static/pubs/decisions/stuart_unwin.pdf

<http://www.fsa.gov.uk/static/pubs/final/martin-lafrance.pdf>

<https://onlineservices.cliffordchance.com/online/freeDownload.action?key=OBWlbFgNhLNomwBl%2B33QzdFhRQAhp8D%2BxrlGRel2crGqLnALtlyZe2C%2BeX1r4MizldRWRmh9PYzp%0D%0A5mt12P8Wnx03DzsaBGwsIB3EVF8XihbSpJa3xHNE7tFeHpEbaelf&attachmentsize=136420>

http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/final/dr_san dradee_joseph.pdf

<https://onlineservices.cliffordchance.com/online/freeDownload.action?key=OBWlbFgNhLNomwBl%2B33QzdFhRQAhp8D%2BxrlGRel2crGqLnALtlyZe8Xx43hgBYD7625E%2BXMRFynp%0D%0A5mt12P8Wnx03DzsaBGwsIB3EVF8XihbSpJa3xHNE7tFeHpEbaelf&attachmentsize=84178>

FSA imposes first fine for Listing Rule systems and controls breaches

The FSA has (on 26 April) fined **Exillon Energy plc** ("Exillon") £292,950 for breaches of its Listing Rules ("LR"). The action is the first time the FSA has fined a company for breaches of rules relating to party transactions or for failing to establish and maintain systems and controls necessary to comply with the Listing Rules.

In the 12 month period following its listing as a FTSE 250 company in December 2009, Exillon made

payments totalling £930,000 to and on behalf of Maksat Arip, its then Chairman and a beneficiary of a family trust which is the company's the major shareholder. The payments continued an informal arrangement in place prior to Exillon's listing whereby Exillon advanced money to Mr Arip for private purposes and then offset those payments against unpaid salary and Mr Arip paid or received the net balance. Exillon realised in February 2011 that such payments were related party transactions pursuant to Listing Rule 11.

The FSA found Exillon to be in breach of Listing Rule 11.1.10R(2) as it had failed to identify the payments to Mr Arip as related party transactions and Listing Principle 2 as it had failed to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

In particular, the FSA concluded that the related party policy did not work in practice as it relied too heavily on senior officers to identify and take appropriate actions and as those charged with this responsibility lacked the requisite experience and training.

There was no conclusion by the FSA that Mr Arip acted improperly in relation to the payments made to him, that Mr Arip or Exillon benefited financially from the payments or that Exillon's shareholders suffered any losses.

Exillon agreed to settle at an early stage in the investigation and therefore qualified for a 30 per cent reduction in penalty. Under the FSA's penalty calculation procedures as set out in its Decision Procedure and Penalties Manual ("DEPP"), the penalty was also reduced from an initial starting point of £465,000 (half of the value of the related party

transactions) to reflect remedial action taken by Exillon, its co-operation during the FSA's investigation and the fact that it had repaid the payments with interest before it became aware that they constituted related party transactions.

<http://www.fsa.gov.uk/static/pubs/final/exillon-energy.pdf>

Administrative Court rejects challenge to Keydata action

The FSA has successfully resisted a challenge pursued by **Stewart Ford** to its investigation ("**the Investigation**") into his involvement in the provision of allegedly defective retail investment products by **Keydata Investment Services Limited** ("**Keydata**") (which was placed into administration, at the FSA's request, in June 2009).

Mr Ford, a former director of Keydata, was issued with a warning notice ("**the Warning Notice**") in October 2010 in connection with the Investigation, which has been ongoing since 2007.

Since then, the regulatory action against Mr Ford has, for some time, remained stayed pending the determination of a challenge pursued by him, by way of judicial review, to the use by the FSA of material disclosed to it by Keydata's administrators which, he argued, was subject to joint interest legal professional privilege.

In October 2011, Mr Justice Burnett upheld Mr Ford's challenge in part, finding that privilege did attach to some material ("**the Privileged Material**") which had been considered by the FSA during the course of the Investigation, and which it had referred to in the Warning

Notice and a supplementary investigation report ("**SIR**") which it had distributed to organisations including the Serious Fraud Office ("**SFO**"), Financial Services Compensation Scheme ("**FSCS**"), foreign regulators and others involved in the administration of Keydata.

Following that ruling, Mr Ford argued that the Court should take a number of steps to avoid prejudice to him, including;

- quashing of the Warning Notice (on the basis that it referred to and/or in part relied upon the Privileged Material);
- ordering the removal from the Investigation of any FSA staff who had read the Privileged Material;
- ordering that no member of the Regulatory Decisions Committee ("**RDC**") who had been involved in the issue of the Warning Notice could be involved in any future stages of the FSA's regulatory action; and
- ordering the FSA to take steps to ensure that all third parties provided with the privileged material in the SIR did not retain or use it, and to produce a witness statement proving that it had done so.

In a judgment handed down on 18 April, but released last week, Mr Justice Burnett rejected the majority of Mr Ford's arguments. Finding that the Privileged Material was "*peripheral but not irrelevant*" to the case against Mr Ford as set out in the Warning Notice, he decided that the Warning Notice should survive in redacted form. He also ruled that it was not necessary to remove FSA staff who have read the Privileged Material from the Investigation, or to make any order as to how the RDC

should be composed. He stated that assurances from the FSA and the bodies to which the SIR had been disclosed were sufficient and that the FSA did not need to be "*policed through disclosure*".

It appears that the regulatory action against Mr Ford will now proceed. Although the judgment in the High Court proceedings refers to the Investigation having been substantially completed, the timescales for the progress of the regulatory action are not yet known.

FSA confirms intention to ban "death bonds"

Following the guidance consultation (GC 11/28) issued in November 2011, the FSA has confirmed, in finalised guidance (FG12/12) issued on 25 April, that it considers traded life policy investments ("**TLPs**"), to be high risk products that should not be promoted to the vast majority of retail investors in the UK.

TLPs are products sometimes known as "death bonds", which often take the form of unregulated collective investment schemes, and which invest in (typically US) life insurance policies by buying the right to payouts upon the death of the original policyholder. At the time it entered into administration, portfolios held by Keydata (see above) included a large number of TLPs.

The FSA's finalised guidance on TLPs has been accompanied by a press release reiterating, in terms similarly strong to those used when it announced the guidance consultation last year, that this latest step is an interim measure designed to restrain sales of TLPs until measures preventing the sale of TLPs and other unregulated collective

investment schemes to most UK customers can be put in place.

The FSA is not yet able to take steps to ban the sale of products such as TLPs. However, it is anticipated that the Financial Conduct Authority ("FCA") will receive such powers if, as it is expected they will, the proposed product intervention provisions of the Financial Services Bill emerge from the parliamentary process as currently drafted.

As was also the case when the guidance consultation paper on TLPs was issued in November, the issuing of the finalised guidance coincides with a speech given by Steven Maijor, Chair of ESMA, in which he has reiterated his wish for ESMA to receive powers to ban unsuitable products from the European retail market.

http://www.fsa.gov.uk/library/policy/financial_guides/2012/fq1212

<http://www.fsa.gov.uk/library/communication/pr/2012/041.shtml>

http://www.fsa.gov.uk/library/policy/guidance_consultations/2011/11_28.shtml

[Speech](#)

Other changes to rules and guidance:-

Changes to pension transfer value analysis assumptions

The FSA has (on 27 April) issued a policy statement (PS12/8) clarifying and updating the assumptions and guidance which firms must use when comparing the benefits likely to be paid under a defined benefit scheme with the benefits provided by a personal or stakeholder pension.

<http://www.fsa.gov.uk/static/pubs/policy/ps12-08.pdf>

Proposed changes to qualification requirements in Training and Competence Sourcebook

The FSA has (on 24 April) issued a consultation paper (CP12/8) proposing the addition of three qualifications to its Training and Competence Sourcebook ("TC").

Firms are invited to comment on the proposed changes by 31 May 2012.

<http://www.fsa.gov.uk/library/policy/cp/2012/12-08.shtml>

FSA contacts over 76,000 potential victims of fraud

The FSA has sent letters and e-mails to 76,732 individuals, whose names appear on lists recovered from companies which it believes have attempted to fraudulently sell investments.

The contact, part of an initiative known as Operation Bexley, comes at a time when it appears that the FSA will take increasing responsibility for prosecuting "boiler room" and other financial fraud on consumers.

Although the FSA can take criminal action for boiler room fraud, most prosecutions in this area are at present conducted by the SFO. It is reported that, as the SFO targets its resources towards tackling larger cases, the FSA is likely to take the lead.

<http://www.fsa.gov.uk/consumerinformation/scamsandswindles/latest/operation-bexley/operation-bexley-warning>

Hector Sants advocates "constructive tension" between regulators and firms

In his last speech as Chief Executive of the FSA, Hector Sants has

emphasised the importance of individual responsibility and effective corporate governance, and has set out how he envisages the FCA and Prudential Regulatory Authority will operate to incentivise the correct types of behaviour amongst senior executives.

In a wide ranging speech, he reviewed the progress made and lessons learned during his tenure in relation to the encouragement of good governance. He clarified the proposed arrangements for interviews of senior personnel, and underlined that it is expected that both the PRA and FCA will conduct interviews to address their particular remits.

He concluded by observing that the ideal relationship between regulators and firms is one which is neither partnership nor conflict, but rather "constructive tension" where "good regulatory judgments, in general, should be aligned with good business judgments".

<http://www.fsa.gov.uk/library/communication/speeches/2012/0424-hs.shtml>

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