Briefing

BURGES SALMON

Financial Services Series
#9

June 2014

Interaction between regulatory enforcement and civil proceedings

Financial services regulation consists of a complex web of legislation, regulatory rules and guidance and case law that is applied at both a regulatory level and by the courts. This month's briefing looks at how the FCA and the courts interact when it comes to regulatory enforcement.

The cornerstone of financial services regulation in the UK is the Financial Services and Markets Acts ("**FSMA**") and its subordinate legislation, from which the FCA[1], the Financial Ombudsman Service ("**FOS**") and the courts draw their authority to:

- provide redress to consumers (and in some cases businesses); and
- in the case of the FCA, set rules and guidance for the carrying on of regulated activities and discipline authorised firms and persons for breaches.

In many instances, all three of the FCA, the FOS and the courts will have the jurisdiction to deal with the conduct of a financial services firm. This leads to tensions over where the jurisdiction of one body ends and another begins. This can cause confusion for both purchasers of financial services and the firms that supply them.

Fortunately, a number of recent court cases have helped to clarify the boundaries between the FOS, FCA and the courts and how FSMA, the Handbook and the common law interrelate.

How do the provisions of the Handbook interact with FSMA?

The Handbook is in many respects the financial service professional's 'bible' when it comes to complying with regulatory obligations. But it is important to remember that the Handbook sets out the FCA's rules and guidance based upon its interpretation of FSMA and the FCA's obligations - it is not a piece of legislation in its own right.

Key FCA Handbook Provisions

P - Statements of Principle are binding obligations placed on firms that firms must comply with or face enforcement action by the FCA.

R - Rules are also binding requirements set down by the FCA are often expressed as specific applications of the Statements of Principle.

G - Guidance provisions are not binding but instead guide firms on the possible means to comply with Rules and Principles.

E - Evidential provision are non-binding provisions that, if complied with, tend to establish compliance with Rules.

As the provisions of the Handbook represent the FCA's interpretation of FSMA, the court is not obliged to follow the Handbook and is entitled to disagree with it. However, when the court is interpreting FSMA it will do so in light of the Handbook provisions.

The Handbook is therefore still an important instrument to consider in the context of financial services matters before the court.

How do the provisions of the FCA Handbook and FSMA interact with common law?

As noted above, the Handbook contains rules that firms must comply with. Under s.138D of FSMA, certain of those rules give private individuals a right to bring a direct claim for damages against the firm where they have been breached.

Certain conduct by firms, such as product mis-selling, can give rise to rights to claim under both s.138D as well as common law contract and negligence principles. How then does the court deal with these two sets of obligations?

continued overleaf

[1]NB - This briefing does not consider the role of the PRA.

In the case of *Green v The Royal Bank of Scotland* the court clarified that while consumers are entitled to make claims under both s.138D and the normal common law principles in respect of the same subject matter, the duties owed under the two are separate and should not be merged. In other words, the firm's duties in common law do not automatically extend to include the duties owed under s.138D and must be determined on normal common law principles.

Green & Rowley v Royal Bank of Scotland

The claimants argued they had been mis-sold an interest rate swap in breach of common law duties and under s.138D of duties to comply with the Conduct of Business ("**COB**") rules.

The claimants conceded that their s.138D claims were out of time but argued that the common law duties owed by RBS should include all the obligations RBS owed under the COB rules via s.138D.

The Court of Appeal rejected this argument on the basis that (i) Parliament had already provide a clear process by which consumers could make claims for damages under s.138D and there was no justification for the court extending that and (ii) if the court did allow the argument, it would effectively have allowed the claimants to bring their s.138D claims even though they were out of time.

FCA Enforcement and Judicial Review

FSMA lays down the procedure the FCA should follow when taking enforcement action against firms. Broadly speaking this involves setting out the alleged breaches in a Warning Notice, submissions to the FCA's Regulatory Decisions Committee ("**RDC**") and the publication of a Decision Notice.

There is then a right to refer the decision in a Decision Notice to the Upper Tribunal (an independent specialist financial services court) where the entire case can be heard afresh by a judge - this is much wider than a right to appeal.

However, as the FCA is a public body its decisions, such as a Decision Notice or a Warning Notice, are in theory susceptible to a claim for judicial review. There is still some uncertainty as to the extent to which an individual can bring judicial review proceedings while regulatory proceedings are on-going but the case of *R (Willford) v FSA* has given some clarity on the matter.

In that case, Mr Willford had sought judicial review of a Decision Notice that found him guilty of various regulatory failings. Mr Willford argued that the Decision Notice should be quashed on the basis that it did not provide adequate reasons. The court rejected the claim, relying on the fact that Mr Willford was able to challenge the Decision Notice by referring it to the Upper Tribunal. The court re-emphasised the principle that where there is an alternative remedy, such as a right of referral to the Upper Tribunal, judicial review will only be available in the most exceptional circumstances.

Given that the Upper Tribunal has a very broad power to re-consider any aspect of the Decision Notice that has been referred to it, there appears to be very little scope for challenging the FCA enforcement process by judicial review.

Are findings made by the FCA binding on courts?

The FCA is not a judicial body and, therefore, its findings are not conclusive statements of fact.

Factual findings made and published by the FCA will often set out grounds that may give rise to claims by private individuals. For example, a Decision Notice may determine that a firm has mis-sold products or that a trader has manipulated the market in exchange for bribes.

While FCA notices are based upon, one would hope, rigorous investigation and analysis of information gathered by the FCA, they are not binding evidence that a court has to follow. The FCA's findings are not the result of a Human Rights compliant trial procedure (hence the right of a referral to the Upper Tribunal). Therefore, the courts do not have to treat FCA notices as binding statements of fact.

Therefore, although a Decision Notice may record that Bank X mis-sold products to consumers, a consumer bringing a civil claim for damages would still need to prove to the court that the Bank had in fact mis-sold the relevant product to the claimant and that they suffered loss as a result. Again, a Decision Notice is not necessarily based on actual customer detriment.

Nonetheless, the fact that the FCA may have determined a firm or individual to be in breach of its regulatory obligations is still a useful, and in many cases powerful, piece of evidence that the court will not ignore completely.

In the high profile litigation concerning LIBOR-related interest rate swap mis-selling, the FCA's findings that LIBOR had been rigged must in practice have been a significant part of the court's decision not to strike out the claimant's case at an early stage.

The FOS - two bites at the cherry?

The FOS was created to give consumers and small businesses an alternative forum for seeking compensation without having to incur the significant costs and delays involved in court litigation.

However, the FOS only has the ability to make modest awards for compensation (at the time of writing a maximum of £150,000).

For some time there was a perceived wisdom that claimants who had suffered greater losses than £150,000 could make a complaint to FOS for £150,000, and then bring a civil claim for the rest of their losses.

However, in *Clark v In Focus Asset Management*, the Court of Appeal dispelled this belief. The court held that if a consumer accepts a compensation award from the FOS, it cannot then bring a claim on the same complaint before the courts, even if it has suffered greater than £150,000 of losses.

This is a welcome development for firms as it means they no longer face the prospect of having to defend the same claim twice. On the other hand, consumers who have suffered substantial losses need to consider carefully whether to pursue complaints before the FOS or in court.

Contacts

Tim Pope and Matt Walker advise clients on financial services disputes and regulatory matters. For further information please contact them:

Tim Pope, Legal Director
DDI: +44 (0)117 939 2230
Mobile: +44 (0)7968 225096
tim.pope@burges-salmon.com

Matthew Walker, Associate
DDI: +44 (0)117 307 6002
Mobile: +44 (0)7812 228130
matthew.walker@burges-salmon.com

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