



Enforcement annual performance account 2008/09

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Enforcement Annual Performance Account 2008/09

Background

1. This is our Enforcement Annual Performance Account of the fairness and effectiveness of our enforcement process, which we publish when we produce our *Annual Report*.
2. We include statistical and background information about enforcement investigations and their outcomes. We also provide an assessment of the fairness and effectiveness of the enforcement process. We base this on feedback from firms and practitioners that have been involved in the enforcement process. We also highlight our enforcement strategy.
3. Our *Annual Report* for 2008/09 contains a selection of key enforcement outcomes that highlight our activities for the year; this paper communicates our approach to enforcement more generally.

Effectiveness of the enforcement function

4. During the year, the Executive has considered the effectiveness of enforcement on a regular basis. We are committed to measuring and reporting on our performance – this account is one way of reporting on our effectiveness.
5. The Executive believes we are using the enforcement tool strategically to deliver our credible deterrence philosophy. We are selective in the cases we investigate. Our considerations include:
 - whether the misconduct poses a significant risk to our objectives;
 - if it is serious in nature;
 - if there is actual or potential consumer loss or detriment;
 - if there is evidence or risk of financial crime or market abuse; and
 - whether it is an FSA priority to raise standards in that sector or issue.
6. As well as receiving formal feedback from those involved in the enforcement process (which we discuss below), supervisors provided feedback about the behaviour of firms after we published enforcement outcomes. We are pleased that publishing enforcement action, along with appropriate supervisory follow up, has often led other uninvolved firms and industry bodies to consider whether the enforcement action has implications for their business, systems and controls. For example, we have evidence that firms undertook reviews of their financial crime systems and controls as a result of the AON case; and following the Fox Hayes case, the Solicitors Regulation Authority issued guidance to solicitors highlighting the risks posed by overseas investment schemes.
7. We publish details of our enforcement decisions in our Final Notices. These demonstrate that wrongdoers will be held to account and help the industry to understand the types of behaviour we consider unacceptable. We recognise that we need to be clear about what concerns us. To help achieve consistency and fairness in our decision-making and clarity in the way our messages are expressed, a lawyer independent of the case team reviews all enforcement cases before they are submitted to the relevant decision maker.

Our approach to enforcement

8. Our approach is to achieve credible deterrence in respect of our Financial Services and Markets Act (FSMA) mandate. We focus on cases where we think we can make a real difference to consumers and markets, using enforcement strategically as a tool to change behaviour in industry. We have a range of disciplinary sanctions available – criminal, civil and administrative – and use these sanctions to deliver strong, visible, enforcement outcomes. To achieve credible deterrence, wrongdoers must not only realise that they face a real and tangible risk of being held to account, but must also expect to face a significant penalty.
- We consider the threat of a custodial sentence to be a significant deterrent against market abuse and we are committed to bringing criminal prosecutions against those who abuse the markets. We began three insider-dealing prosecutions during the year and were successful in our first ever insider-dealing trial, securing two convictions and a custodial sentence.
 - Where there is evidence that standards are not improving, and that enforcement outcomes have not had the desired deterrence effect, we are committed to increasing financial penalties. We imposed a record £27.3m in financial penalties during the year, in comparison with an average of £14m over the previous five years.
 - We consider that action against individuals has a greater deterrent effect than action against firms and we are committed to holding senior managers to account for competency and integrity failings. We increased the number of Significant Influence Function holders (SIFs) under investigation threefold during the year, and fined four SIFs a total of over £200,000.
9. You can find a breakdown of cases the Enforcement Division investigated during 2008/09 and their outcomes on page 8.

Thematic reviews

10. Last year we published a number of outcomes in disciplinary cases that arose as a result of thematic reviews. For example, we continued to take action and investigate firms and individuals for failings in Treating Customers Fairly, particularly in relation to pensions switching and the selling of payment protection insurance (PPI). We identified these areas as posing a risk to our consumer protection statutory objective and conducted extensive thematic reviews, which included telephone interviews, firm visits and mystery shopping. This work resulted in a number of referrals to enforcement. By taking enforcement action against these firms, we aimed to support the findings of thematic work, to promote behavioural change in industry, and to seek fair treatment (including compensation where appropriate) for customers of disciplined firms.
11. Last year we worked with the Council of Mortgage Lenders and the Intermediaries Mortgage Lenders Association to re-launch the Information from Lenders initiative. The re-launch saw a 25% increase in the number of suspected mortgage fraudsters reported to the FSA. We took action against authorised brokers who posed a serious threat to consumers, to lenders and to the integrity of the financial markets. During the year, we prohibited 23 brokers for their involvement in mortgage fraud and imposed three financial penalties of over £100,000.
12. Our enforcement strategy for small businesses is driven by the way we supervise these firms. Last year, we continued to pursue our enhanced strategy for the supervision of small firms. This focuses on increased supervision of and contact with small firms on a regional basis. During the year, we completed assessments of some 2000 firms from the first four regional programmes (Northern Ireland, North West, West Midlands and South West). All four regional programmes resulted in enforcement investigations. We also continued to assess small firms on a thematic basis, with supervisors assessing and addressing the issues of greatest concern to them across the sector. Last year, thematic work led to substantial enforcement action against small firms, particularly in relation to the quality of mortgage and investment advice. To support thematic work and the enhanced strategy we doubled the number of small firm enforcement teams from two to four.

Consumer redress

13. It is common for enforcement actions in retail cases to include a redress element that, if appropriate, tries to put the customer back in the position in which they would have been before the misconduct or compensates them, or both. One of the benefits of settled cases is that this redress can be agreed as part of the enforcement outcome and may be provided more quickly than if the case proceeds to the RDC and the Financial Services and Markets Tribunal (the Tribunal). During the year, we required over 30 firms to review their past business, contact consumers and pay redress as appropriate.
14. We imposed financial penalties on nine firms for failings in relation to PPI. These firms agreed to carry out a consumer contact exercise and pay redress where appropriate. During settlement discussions, we worked with firms, with the consumer group Which? and with external consultants to ensure that communications with affected consumers were clear, fair and would help to identify where redress should be paid. We anticipate that total redress packages will exceed the £8.9mn imposed in financial penalties.

Consumer protection

15. We have continued to take direct action against UK firms that helped unauthorised overseas firms involved in share fraud, commonly known as boiler rooms, unlawfully to promote and sell shares to UK consumers. We took regulatory action against Fox Hayes, an authorised firm that approved financial promotions used by overseas share fraudsters to defraud consumers. Following our appeal of a Tribunal decision, the Court of Appeal found that Fox Hayes had broken our rules and increased the penalty from £146,000 to £950,000. We took civil action against Bayshore Nominees Ltd (Bayshore), an unregulated UK firm that helped share fraudsters by arranging the transfer of money and shares. The High Court required the owner of Bayshore to return £1m to UK investors. We also used our powers to obtain injunctions to freeze assets and restrain the activities of two firms and three individuals.
16. We continued to educate consumers about the danger posed by share fraudsters. We issued over 300 consumer alerts against individual firms, we worked with industry bodies to design educational material, and we wrote to 11,000 UK shareholders to warn them that their personal details were on fraudsters' databases.
17. In November 2008, we hosted the first ever International Share Fraud conference, bringing together key stakeholders from across the globe to discuss collaborative strategies for tackling the fraudsters. The conference produced several strategies, including a commitment to create an international share fraud database, which will result in greater international collaboration in fighting share fraud.

Capital markets

18. We continued to focus on market misconduct cases and, to increase the deterrence effect, we are committed to bringing criminal prosecutions and increasing civil financial penalties. We have made it a priority to tackle market professionals, repeat offenders and organised insider dealing rings. We also pursue cases of opportunistic misconduct, especially where those are, because of their profession or role, committing a serious breach of trust. Last year we were successful in our first ever criminal prosecution for insider dealing. Christopher McQuoid was sentenced to eight months imprisonment, James Melbourne received the same sentence suspended for 12 months. Dismissing McQuoid's appeal against sentence, the Court of Appeal linked insider dealing to theft and described it as a type of fraud. The effect of this decision is that insider dealing will usually warrant a substantial prison sentence. We believe such sentences send a strong message – insider dealing is serious criminal conduct which carries a significant penalty. We began proceedings in a further three criminal prosecutions and conducted two major search and arrest operations against suspected insider dealing rings during the year. We recognise that not all such prosecutions will be successful but believe that visible activity of this sort is an important part of credible deterrence.
19. In parallel with our criminal investigations, we continued to use civil powers where appropriate. Last year we imposed financial penalties totalling £670,000 on eight individuals and one firm for market abuse. These penalties comprise a 'disgorgement of benefit' element, to strip wrongdoers of their profits, and a deterrent element. We have also made clear that we will continue to increase financial penalties in cases we pursue through the civil route. In March 2009, the Tribunal upheld our decision to impose a financial penalty of £4m, our largest market abuse penalty to date, on Winterflood Securities.

20. We believe that industry participants should work with us to maintain clean UK markets; we have sought to engage the industry on the issue of market integrity via speeches, Marketwatch newsletters, and thematic work. Where industry participants fail to work with us by failing to have adequate systems and controls to prevent market abuse, we will take action. Last year we imposed a financial penalty of £5.6m on Credit Suisse for such failures.

Financial Services and Markets Tribunal

21. Last year the Tribunal heard five references from firms or individuals that referred matters arising from a Decision Notice. The Tribunal found in favour of the FSA in all five cases. When we appealed a Tribunal decision for the first time, in the case of Fox Hayes, the Court of Appeal found in our favour. We are determined to take the action necessary to achieve the right regulatory result. We expect the number of Tribunal references to increase as we take tougher action against both firms and individuals. We are committed to taking difficult cases, and we expect that the Tribunal will not always uphold our original decision. Unsuccessful Tribunal outcomes will not deter us from taking on difficult cases, nor will they alter our resolve to pursue appropriate cases.
22. You can find a breakdown of the number and type of referrals during 2008/09 on page 8.

International work and policy

23. A significant proportion of our time is spent responding to international requests for assistance, and last year saw a 25% increase once again on the number of requests made the previous year. We expect this trend to continue. We also made an increasing number of requests for help ourselves, both for regulatory investigations and in the form of mutual legal assistance requests for investigations being conducted on a criminal footing. Mutual assistance is sought to locate witnesses and subjects of investigation, to use the powers of overseas regulators to obtain documentation or information located overseas, and to conduct interviews with individuals based overseas. Constructive and effective relationships with our counterparts will continue to be vital to our ability to deliver case outcomes and meet our international obligations. Towards this goal, we play an active role within the International Organisation of Securities Commissions and at the Committee of European Securities Regulators to promote information sharing and cooperation between the FSA and overseas regulators.
24. In December 2008, following consultation, we made changes to our Decision Procedures and Penalties manual (DEPP) and our Enforcement Guide (EG). The changes included the introduction of a leniency factor for suspects who come forward with information and assistance in multi-party misconduct cases; increased use of our power to vary a firm's permission on our own initiative; and a new chapter in EG which sets out enforcement powers that we have under legislation other than FSMA. The case of Richard Ralph and Filip Boyen demonstrates the new leniency policy. Ralph and Boyen informed the FSA of their misconduct, cooperated fully with our investigation, and provided us with information about market misconduct. But for that cooperation, serious consideration would have been given to taking criminal proceedings.
25. We have been successful in our request to the government to gain the power to grant statutory immunities. This proposal was included in The Justice and Coroners Bill, introduced in the House of Commons on 14 January 2009. This complements our new leniency policy and enables us to incentivise less culpable parties to come forward and provide evidence against those who played a greater part in market misconduct.
26. When we published DEPP and EG, we made a public commitment to review these materials at least annually and to consult on any changes we made to EG, even though EG is not subject to formal consultation requirements. We have completed a review of penalty setting and will be consulting on proposals to introduce a new penalties regime. The proposals include a more formalised penalty setting framework that will provide greater transparency around penalty setting.

Summary of feedback meetings

27. At the conclusion of an enforcement case, we give those who have been investigated the opportunity to comment on their experience of our enforcement procedures and subsequent decision making. These meetings focus on the handling of the practical and procedural aspects of the case by the FSA staff and decision makers, not on the outcome of the case. The opportunity to give feedback has usually been available in all disciplinary cases which have closed since 10 October 2005, including those which settled or discontinued. But it is not available for investigations – such as unauthorised activity investigations – where the only RDC involvement is to approve the start of civil or criminal proceedings.

28. During this financial year, we received feedback from 15 firms and individuals. We carefully consider the key themes raised and are working hard to ensure that we take forward the lessons learned. The key issues raised include the following.
- We received favourable comments about the professionalism of our staff through the enforcement process.
 - The scoping meetings at the start of cases have been found to be helpful.
 - Most firms and individuals found that our investigation took too long, but others acknowledged that investigations were as short as could be expected.
 - Comments on our level of communication were evenly split: although we had some positive comments about clear drafting of Investigation Reports and document requests, we continued to receive some negative comments about the level of communication in other areas.
29. The issues raised were fed back to individual case teams and are often incorporated into wider good-practice messages communicated across the FSA. On our level of communication, we note that this is still an issue for some respondents. Firms and individuals can expect that during some periods of investigation – for example during evidential review – contact will be reduced. However, we continue to work on improving the communication we give when this is possible to do.

Executive settlement

30. Since October 2005, we have been able to conclude settled cases on the basis of an agreement by two FSA directors.
31. Between 1 April 2008 and 31 March 2009, 71 cases were concluded by executive settlement. During that period, 118 cases were referred to the RDC. Over three-quarters of cases with a disciplinary outcome settled before reaching the RDC and almost all cases involving a financial penalty settled during the first settlement stage, receiving the full 30% discount on the financial penalty. Two of 71 settled cases settled during the second settlement stage, receiving a 20% discount on the financial penalty. One case settled after the third settlement stage, so no discount was given.
32. The key features of the executive settlement procedure are direct involvement of executive management, strict timescales and a financial discount. Executive settlement allows us to secure prompt redress in consumer-related cases, including requiring firms to take steps to remediate, send timely messages to the industry and achieve swift and effective outcomes. This enables us to use resources more efficiently and achieve prompt change in industry behaviour. This is especially important in cases where we are attempting to address a thematic issue. By contrast, contested cases (which may be the more complex and/or multi-party cases) typically have significantly extended timescales. Executive settlement has many benefits, but, we will only settle for the right regulatory outcome. Also, we recognise the importance and significance of our published outcomes and that we need to demonstrate clarity and consistency.

Conclusions

33. During the year the Enforcement Division delivered a number of strong, visible, results – we imposed financial penalties of over £27mn, we prohibited 58 individuals, and we were successful in our first ever criminal prosecution. We also received press coverage to suggest we are beginning to deliver the credible deterrence philosophy. We enhanced our capacity by improving processes and technology and by recruiting experienced professionals. Total headcount increased from 225 to 280 during the year, and reached 320 by June 2009. As a result of these changes we believe we are better equipped to deliver credible deterrence.
34. We expect that most cases will continue to settle via executive settlement allowing the FSA and the subject of investigation to conclude the matter efficiently and effectively. However, we believe that our move to impose higher penalties and the more robust approach in our requirements for firms to undertake customer remediation exercises may result in a greater number of referrals to the RDC and the Tribunal. We are prepared to take cases to the RDC, to the Tribunal and beyond, if we believe that this is necessary to get the outcomes we need to achieve our goal of credible deterrence. We remain committed to ensuring that we continue to operate a process that is, and is seen to be, fair and effective.

Data and analysis

1. Enforcement Statistics from the *Annual Report* (including a summary of the work of the RDC)
Appendix 5 of the 2008/09 Annual Report – Enforcement activity

Enforcement cases opened and closed in 2008/09

Issue ¹	At start	Opened	Closed	Outstanding
Selling	45	18	38	25
Pensions and Endowments	0	0	0	0
Investment management	0	3	0	3
Unauthorised activities	17	7	6	18
Systems & Controls	47	40	45	42
Market Protection	32	11	17	26
Listing Rules	1	3	3	1
Fitness & Propriety Issues	24	21	20	25
Non-cooperation with FSA	0	1	1	0
Money laundering controls and Financial Fraud	21	61	23	59
Totals (Excl TCT)	187	165	153	199
TCT	50	160	149	61
TCT RMAR cases	21	309	323	7
International requests	77	830	787	117

Notes:

1. Cases may include both firms and individuals
2. These are cases against regulated firms that failed to meet FSA minimum standards (Threshold Conditions)
3. The Retail Mediation Activities Return (RMAR) enforcement project began in October 2005. It is a project focused on ensuring that firms comply with our requirement to submit electronic returns
4. Table updated on 11 June 2010.

Appendix 8 of the 2008/09 Annual Report – Statistics (refer to page 5 for information on the RDC).

2. Private Warnings

During 2008/09, we issued in total 43 private warnings. 38 of these were issued by Enforcement.

3. Referrals and Decisions of the Financial Services and Markets Tribunal

The record of referrals and outcomes for 2008/09 is recorded in the table below.

Type of cases	Live	Outcome		
		Tribunal Decision	Dismissed without substantive hearing	Withdrawn
TCT	0	1	1	2
Authorisation	2	2 (1 in favour of applicant)	0	2
Market Abuse	4	3	1	0
Regulatory	9	2	2	1
TOTALS	13	8	4	5

This table includes referrals and decisions within the relevant financial year. Some of the cases in which decisions were made were, however, referred in previous years.

4. Total number of cases

Between 1 April 2008 – 31 March 2009, 22 cases were referred to the Tribunal. This is lower than 2007/08 when 25 cases were referred.

5. Types of cases

- a. TCT: these cases involve firms that have failed to satisfy threshold conditions.
- b. Authorisation: these cases relate to refusals to authorise firms or to approve individuals.
- c. Market abuse: these cases relate to allegations of market abuse against individuals.
- d. Regulatory: these are regulatory disciplinary cases against authorised firms or individuals.

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