

Compliance Monitor

The monthly briefing service for compliance specialists

When the regulator calls – how to handle a themed visit

*Themed visits are one of the methods by which the FSA gathers information in order to improve its understanding of particular industry areas or so as to assess the validity of concerns it has about risks that those areas might pose to its objectives. Alongside policy making, ongoing supervision and its other tools, the FSA considers the conduct of themed visits to be a key method to help it achieve its regulatory objectives [1]. Recent themed visits have been carried out in relation to payment protection insurance, hedge funds and contract certainty. In this article, **Andrew Hart** and **Oliver Kerridge** of Freshfields look at how the firm should respond when the regulator calls.*

It is worth noting at the outset that as an alternative to conducting themed visits to individual firms, the FSA also conducts thematic reviews by collecting data from firms and comparing it to see where potential weaknesses lie. On occasion, the FSA will conduct both themed visits and a thematic review. For example, as part of a drive to understand whether its supervisory approach is effective and proportionate in the private equity market, the FSA has conducted a number of themed visits to market participants and has sent firms a survey to complete. Although this article concentrates on themed visits, many of the points made are equally applicable to thematic reviews.

Given that themed visits, by definition, take place in areas that are of importance or concern to the FSA, firms that are visited are proportionately more likely to end up being referred to the Enforcement Division [2]. This article examines the nature of themed visits and how you can deal with them so as not to end up in enforcement proceedings.

The procedure for themed visits

How are themed visits conducted? First, the FSA will identify an area about which it has concerns or wishes to find out more. Areas may be identified by supervisors, policy work, or by looking at trends in complaints. Once various areas have been identified, the business units [3]

determine which areas need to be addressed and how to address them. The business units might decide that it would be appropriate to conduct themed visits in order to achieve the following objectives: to identify good practice, to address identified risks or to determine the scale of risks identified from intelligence or surveillance.

Once it has been determined that themed visits are appropriate, the FSA will have to decide which firms to visit. Depending on the focus of the themed visit, the FSA might want the sample of firms to be representative of a market or product or it might want them to reflect the differing standards that exist in the market. In cases where a problem has already been identified, it might deliberately decide to include an implicated firm. A firm may be included because of its prominence within the market place and not because previous supervisory visits have raised concerns. The number and type of firms visited will therefore depend on the subject matter of the visit but generally a sample of around ten firms will be visited [4]. For example, when the FSA visited firms in order to gain an understanding of their preparations for Pillar II of the Capital Requirements Directive, the FSA chose twelve firms, eleven of which were large and complex financial institutions.

The FSA will then notify the firms that the themed visits are taking place and also take the opportunity to ask for information in advance. The timing of the themed visit will be agreed between the FSA and the firm. The length and format of the themed visit will depend on the matter under consideration. However, if the FSA is interested in the detail of your policies and procedures, they may ask for them before the visit. During the visit, the FSA may be less concerned with the wording of your policies and procedures but concentrate on how they are implemented and whether employees follow them in spirit. As part of this, the FSA may ask to look at a number of sample transactions.

Those conducting the themed visits will then write them up and present them to an internal project board.

On occasion, the findings and proposed communication plan will also be forwarded on an anonymous basis to committees with representatives both from the FSA and trade bodies. Where the FSA considers that the results might have a significant impact on the sector, the FSA may send out a Dear CEO letter or a newsletter setting out the findings of the visits, sharing good practice and setting out the FSA's expectations. The FSA considers the communication of the results of its thematic work to be very important in order to communicate best practice to firms and to highlight where risks might arise. On occasions, however, as indicated above, the FSA may decide to take enforcement action on the basis of a themed visit.

How to deal with themed visits

As has already been stated, themed visits are only one of the methods by which the FSA gathers information regarding a sector of the market about which it has concerns. Whilst the themed visits will not be formal investigations into the firms selected, they can lead to enforcement action being taken [5] and can be more hostile in tone than regular visits by a firm's supervisor. On occasion, themed visits can be conducted in conjunction with the FSA Enforcement Division. With this in mind as well as the duty to be open and cooperative with the FSA [6], how should you deal with themed visits?

On being informed that a themed visit is going to take place

When you know that a themed visit is going to take place, the first step you should take is to set up a core team to deal with the visit. By doing this, you can monitor the information flow to the FSA, identify key personnel in the area that is to be investigated and ensure that both you and they are prepared. The team might consist of representatives from in-house legal, risk, compliance and in some instances, it may be useful to have a representative from the relevant business area. Given the FSA's focus on senior management responsibility, senior management should be informed about the visit and be ready to talk to the visitors. Whilst you should not respond in an overly formal or legalistic manner, you will need to take care about the way in which you respond to the FSA.

The next step will be to find out the exact scope of the area that the FSA is investigating. For example, it may be prudent to ask the FSA how many people will be conducting the visit, whom they expect to interview and what documents they expect to see. This will also be

useful to ensure that the correct people are present when the visit is conducted and that documentation is taken out of storage. If the FSA has asked for information or documents in advance of the visit, do they shed light on the focus of the visit?

You should also be aware that the FSA may visit not only your firm, but also its advisers, clients, counterparties and companies to which it has outsourced any of its functions.

During the visit itself

Those conducting the visit are unlikely to be the firm's normal supervisors and therefore will be unlikely to have knowledge of the processes at your firm. It may be advisable for members of the core team to be present in order to take questions. The core team will also be able to help the FSA select persons to be interviewed and locate relevant documents.

Where the FSA does take copies of documents, you should keep records of what those documents are for future reference. This will enable you to deal more effectively with any requests for explanations or for further material. You should also check if you are asked to provide legally privileged documents to the FSA [7].

During the visit, the FSA may ask to interview your employees. Although such interviews are not the same as interviews conducted in formal FSA investigations [8], similar considerations should apply. By this stage you should have already identified the key personnel in the area under investigation. Accordingly, you will be able to suggest to the FSA the most appropriate people to be interviewed. Care should be taken so as to ensure that interviewees do not provide answers where they are simply guessing or speculating as they have no real knowledge. It will always be possible to follow up any unanswered questions with a letter.

A more difficult decision will be whether a representative of legal or compliance should be present at the interview. Generally, it will be helpful to attend so that they can see how the visit is progressing, assist in the provision of information to the FSA and ensure that individuals with relevant knowledge speak to the FSA. However, even if the representative is legally qualified, any notes that are taken of the interview are very unlikely to be protected by legal professional privilege and may therefore be disclosable in any subsequent proceedings.

After the visit

The period after the visit will be important for ensuring that any misunderstandings that have arisen from the visit do not lead to the taking of enforcement

action. An example of how unresolved misunderstandings can lead to action being taken is the Legal & General case. In that case, a supervisory visit took place in early 1999 which revealed that only 5% of endowment mortgage sales were likely to be unsuitable. This was followed by an endowment mortgage themed visit which, having concluded that 35% of sales were unsuitable, led to enforcement action being taken against Legal & General without any warning. This was despite the fact that the supervisory visit had not raised any concerns and far fewer client files had been reviewed in the themed visit than in an ordinary supervision visit. However, before the enforcement action was taken, Legal & General were not informed as to the results of the themed visit and therefore did not have the opportunity to query them.

There are two ways in which you can clear up misunderstandings. First, you may choose to send a letter to the FSA. In the letter you can also answer any questions that you were not able to during the visit. Second, you can ask the FSA to conduct a debrief. The debrief will give you the chance to identify any concerns the FSA has and see how the firm stands in relation to its peer group.

Notes

1. See The FSA's Thematic Work Programme presentation by Vernon Everitt on 28 February 2006. The FSA's four regulatory objectives are set out in FSMA 2000, ss 3-6 and are: maintaining confidence in the financial system, promoting public understanding in the financial system, securing appropriate protection for consumers and reducing financial crime.

2. See 'Efficiency versus Fairness?' speech by Margaret Cole at the FSA Enforcement Law Conference on 16 June 2006. Examples of firms against whom enforcement action has been taken following themed visits include: Legal & General, Hargreaves Lansdown, Royal & Sun Alliance, Scottish Amicable and Guardian Assurance.
3. The FSA's three business units are: Regulatory Services, Retail Markets and Wholesale and Institutional Markets.
4. Although 40 firms were visited in the FSA's recent payment protection insurance themed visits.
5. Generally, the FSA uses its informal information gathering powers when conducting themed visits. See the FSA Handbook at SUP 2.3.1.
6. Principle 11 imposes a duty on firms to be open and co-operative with the FSA. The duty is expanded upon in SUP 2.3.3ff. There is a similar duty for Approved Persons which is set out at Statement of Principle 4.
7. Note that the FSMA 2000 contains its own definition of legal professional privilege at section 413. This provision broadly mirrors the common law doctrine of legal professional privilege.
8. Unlike interviews in formal FSA investigations, interviews during themed visits are unlikely to be tape-recorded.

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Ten tips for dealing with a themed visit

- Find out the exact scope of the area that the FSA is investigating and check for any previously publicised concerns the FSA has;
- Form a core team to deal with the visit and draw up a list of key employees to whom the FSA are likely to want to talk and prepare them for the visit;
- Remember that those conducting the visit are unlikely to be your normal supervisors and will therefore be unlikely to have knowledge of the processes at your firm;
- Take care regarding the disclosure of privileged documents to the visitors or the creation of documents likely to be unhelpful in future civil or regulatory proceedings;
- Keep records of what documents have been copied by the visitors;
- Be present when the visitors interview employees but remember that notes of the interviews are very unlikely to be protected by legal professional privilege;
- Ensure that interviewees do not answer questions when they are purely guessing at the answers. Uninformed speculation helps neither the FSA nor the firm and can lead to unnecessary time being incurred in sorting out any confusion which arises;
- Remember that you may not be able to answer all questions at the visit but can always follow up with a letter;
- Ask for a debrief both so as to obtain feedback and understand what areas may be of concern to the FSA and so as to clarify any misunderstandings; and
- Remember that the FSA may visit not only the firm itself, but also its advisers, clients, counterparties and companies to which it has outsourced any of its functions.