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## RESPONDING TO A SECTION 166 NOTICE – ALL IS NOT LOST ...

### Introduction

Section 166 of the UK Financial Services and Markets Act 2000 empowers the Regulator<sup>1</sup> to require<sup>2</sup> that an authorised firm appoints<sup>3</sup> a ‘skilled person’<sup>4</sup> to report on specific matters of concern or requiring verification. The Regulator must first approve the firm’s proposed choice of ‘skilled person’<sup>5</sup>. The firm must provide “all such assistance” as reasonably required by the ‘skilled person’ and pay the latter’s fees. Ordinarily, a section 166 review will culminate in a report, outlining the ‘skilled person’s’ findings. A section 166 review may lead to a formal investigation, enforcement proceedings, the mandating of additional review(s) or a no further action (‘closure’) confirmation.

**Contrary to popular belief, the issuance of a section 166 requirement notice does not necessarily constitute a total loss of control for the recipient firm. Indeed, there are a number of measures that a firm can *legitimately* take to optimise its position.**

### The ‘Skilled Person’s’ Perspective

A section 166 review presents a somewhat strange dynamic for the ‘skilled person’. Unlike ‘normal’ assignments, the ‘skilled person’ must report to both the firm and Regulator – parties with often divergent interests. Commonly, the ‘skilled person’ will be required to engage in bilateral communications with the Regulator, with no visibility to the firm<sup>6</sup>.

A ‘skilled person’ should appreciate a cooperative and constructive approach by the firm<sup>7</sup>. Conversely, sycophancy, hostility and defensiveness will likely prove counter-productive. More generally, the ‘skilled person’ may well – consciously or otherwise – be influenced by good or bad perceptions and experiences of the firm during the course of the review process.

Finally (and importantly), the ‘skilled person’ will have considerable latitude as to the manner and tone in which its findings are presented. The very same observations can – within legitimate bounds - be painted in an inherently negative or positive light. Accordingly, **it is vital that the firm maintains as positive a working relationship with the ‘skilled person’ as is possible in the circumstances – to maximise the chances of a fair ‘hearing’ and balanced portrayal.**

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<sup>1</sup> The Financial Conduct Authority or Prudential Regulation Authority.

<sup>2</sup> Via a Requirement Notice.

<sup>3</sup> The Regulator can itself directly appoint – although, in practice, this will be more the exception, rather than the rule.

<sup>4</sup> An external specialist – such as a law firm, accountancy practice or compliance consultancy.

<sup>5</sup> Where not appointed directly by the Regulator; and which is likely to have been chosen from a designated panel.

<sup>6</sup> As required, the firm will have consented to such bilateral dialogue in any terms of engagement with the ‘skilled person’.

<sup>7</sup> Although any sense of panic and/or over-hasty remedial steps may prove counter-productive.

## Practical Considerations for Firms

As the following (non-exhaustive) examples illustrate, there are a number of ways in which a firm facing a section 166 review can **legitimately** help itself.

### *Choice of 'skilled person'*

In the majority of cases<sup>8</sup>, a firm will be able to influence the choice of 'skilled person'. Typically, the Regulator will require the firm to procure three or four proposals from a panel of designated external professionals. In such instances, it is common for firms to hold a 'beauty parade', with a view to selecting a preferred candidate; for subsequent vetting (and, hopefully, approval) by the Regulator. Crucially, the proposed 'skilled person' will need to be adjudged sufficiently independent to undertake the required review - a key consideration for the Regulator.

Any such selection process can afford a real chance at the outset for the firm to:

- ❖ Determine the mind-set and likely approach of the 'skilled person' – for example:
  - Will the 'skilled person' adopt a fair-minded approach and produce a balanced end report (whatever it may find)?
  - Can the firm expect regular and constructive dialogue with the 'skilled person', so as to prevent any 'nasty surprises'?
- ❖ Focus on the directly relevant credentials and experience of proposed team members – including whether the individuals possess a sufficient understanding of the areas under scrutiny and the firm's operational processes and organisational set-up
- ❖ Obtain a resourcing commitment by the 'skilled person' – to ensure adequate capacity throughout and timely completion

### *Scope of review*

Commonly, a tri-partite<sup>9</sup> 'kick-off' meeting will be held at the outset of the 'skilled person' review. This will represent the last opportunity for the firm to seek to narrow or clarify the scope of the review<sup>10</sup>; and to influence the timetable.

### *Managing the 'skilled person'*

Even once a 'skilled person' has been appointed, a firm can positively (and legitimately) seek to influence the review process<sup>11</sup>. By way of some obvious examples, the firm should:

- ❖ Remain alert to any apparent knowledge gaps or misapprehensions on the part of the 'skilled person'
  - Pro-actively offering to explain and elaborate
  - Arranging periodic site visits for the 'skilled person', as appropriate – to ensure a proper appreciation of the firm's affairs 'on the ground'
- ❖ Convey a continuous sense of cooperation and desire to assist the 'skilled person' with its enquiries

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<sup>8</sup> Leaving aside those scenarios in which the 'skilled person' is appointed directly by the Regulator.

<sup>9</sup> Involving the firm, the Regulator and the 'skilled person'.

<sup>10</sup> Although clarification is likely to be easier to achieve than narrowing.

<sup>11</sup> Of course, this should never involve (or even be perceived to involve) the exertion of undue pressure and/or any attempt to compromise the 'skilled person's' independence and integrity.

- ❖ Maintain a ‘front foot’ posture throughout the review – for instance, suggesting regular (senior level) update meetings, which can serve to help: (i) keep the ‘skilled person’ focused and on track to meet expected timeframes; and (ii) maintain a constructive and on-going dialogue with the ‘skilled person’ – hopefully, minimising the prospects of any nasty surprises being sprung
- ❖ Endeavour to channel all dealings with the ‘skilled person’ through sufficiently senior level (and well-briefed) personnel – to ensure consistency of approach and message; and build a constructive rapport

#### *Documentation and information gathering*

As soon as the requirement notice has been finalised (if not before), the firm should commence the information collation exercise – the extent of which will depend on the subject-matter and nature of the review. Ideally, this information would be reviewed prior to disclosure to the ‘skilled person’ to ensure that: (i) all files and documents are up-to-date, signed-off, coherent and complete; (ii) any information gaps or missing documents can be accounted for; and (iii) any potential issues are identified and responses prepared.

It is important for firms to bear in mind that the ‘skilled person’ may examine electronic document properties to ascertain the date of creation and last modification. For example, a document that has only recently been modified may serve to arouse suspicion, absent a credible explanation.

#### *Interviews*

It may well be possible to predict likely lines of enquiry by the ‘skilled person’ – based on the contents of the Regulator’s requirement notice and the information requested by the ‘skilled person’.

All prospective interviewees should be identified and well-briefed. It is important that **all** relevant personnel are interviewed – so that the ‘skilled person’ gets a comprehensive and well-rounded picture. The firm should proactively suggest any other individuals (not originally identified by the ‘skilled person’), with whom the ‘skilled person’ might usefully meet. Conversely, if the ‘skilled person’ requests interviews with individuals unconnected to the subject-matter of the review, the firm should tactfully suggest more relevant alternates.

It will often be helpful to have a note-taker present at all interviews. Amongst other things, this can help to ensure that there are no misunderstandings or misconceptions, which can easily find their way into the ‘skilled person’s’ ultimate report. The ‘skilled person’ should be amenable to such a request.

In the same vein, the firm should request that interviewees are invited to review formal meeting notes prepared by the ‘skilled person’ – especially, where they will be referenced in the end report. If afforded the opportunity, it is imperative that interviewees carefully review the draft notes or transcripts – to ensure that they represent an accurate account of the discussion. In practice, this will be the final opportunity for an interviewee to add (and effectively put on record) any relevant further post-interview thoughts or comments.

#### *Draft ‘skilled person’ report*

The draft report may be issued simultaneously to both the firm and the Regulator<sup>12</sup>. While the ‘skilled person’ will typically only invite (and entertain) any comments from the firm on factual accuracy, it nevertheless remains open to the firm to raise (and put on the record) any significant concerns – for example, any manifest

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<sup>12</sup> Although, the firm may sometimes be afforded a prior opportunity to comment upon factual accuracy.

misunderstandings or misstatements. A well-managed process, as advocated, should serve to mitigate the risk of any such concerns ever materialising.

Any comments should be collated and fed back to the 'skilled person' (ideally) in a single communication, rather than piecemeal.

#### *Responding to the report*

As a general matter, firms would be well-advised to retain a calm and measured composure in response to the report. To the extent possible, the firm should convey the impression of embracing the report's findings; and a desire to proceed with implementing the recommendations within a challenging, but realistic, timeframe. If a remedial timetable proposed by the 'skilled person' is overly- ambitious, the firm should push back and explain why more time is required.

In some cases, the 'skilled person' will be required to undertake a post-implementation review. The maintenance of a constructive relationship with the 'skilled person' becomes all the more important in such scenarios.

#### **Conclusion**

This article has highlighted some – but by no means all – of the ways in which a firm facing a section 166 review can legitimately optimise its position. In our experience, these measures are all too often overlooked, leaving the subject firm in an unnecessarily (and materially) disadvantageous position.

All is certainly not lost ...

**Quinn Emanuel's practitioners have extensive section 166 experience and insight – having both acted as a 'skilled person'; and advised subject firms throughout the course of such reviews (including in their interactions with the 'skilled person').**

**Additionally, Quinn Emanuel has conducted numerous independent (quasi-section 166) reviews – commissioned by firms as a pre-emptive measure, with the aim of avoiding formal regulatory action. Quinn Emanuel is uniquely placed in: (i) being genuinely independent and impartial – a matter of increasing focus for the Regulator; and (ii) possessing the requisite credentials and credibility to undertake such important assignments.**

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