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CONDUCTING INTERNAL INVESTIGATIONS

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Macfarlanes has a leading white-collar, regulatory enforcement and investigations practice. The firm represents major financial institutions and multinational corporations, as well as their boards of directors and senior executives, in complex, high profile and often highly sensitive investigations, enforcement actions and litigation both in the UK and internationally. Many of the matters they advise on threaten their clients' reputations and businesses. The partners are highly experienced in dealing effectively with these threats and have an outstanding track record – often helping to deter significant enforcement action and litigation. The firm has extensive experience dealing with all key regulators and enforcement agencies.

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Dan Lavender is a litigation partner. He specialises in financial services litigation and investigations. He has worked extensively on high-value, complex, multi-jurisdiction matters, and frequently in cases where the client's reputation and business are under severe threat. He is experienced in helping clients to achieve both sensible and commercial solutions; and managing relationships with regulators in a number of jurisdictions.

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CD: Reflecting on recent months, could you provide an overview of some of the prevailing causes of companies launching an internal investigation? Are you seeing any common themes?

Lavender: It is now much more common for firms to consider launching an internal investigation as a defensive or proactive measure. If a peer market participant is alleged to have engaged in misconduct, a firm will want to make sure that its own house is in order. Financial regulators in particular now expect firms to monitor industry developments and to launch their own investigations wherever necessary. Generally, conducting a voluntary internal investigation is perceived to be a good protection mechanism. However, firms need to be mindful that in some jurisdictions there is an obligation to report misconduct to regulators – for example the Financial Conduct Authority (FCA) in the UK. Many regulators will assess a firm's response to an issue – including whether the firm decides to bring its own voluntary investigation – as one of the criterion when deciding whether or not to bring enforcement action.

McCahearty: A key theme over recent months has been the increase in investigations into potential tax evasion. The impact of the Panama Papers continues to be felt and in the UK new legislation has been proposed which will introduce a new offence for corporations of failing to prevent tax evasion – this offence has been modelled closely on the corporate offence of failing to prevent bribery under the Bribery Act. These changes have led many businesses to more closely scrutinise their tax affairs and those of their customers and clients. Politicians are under increasing pressure to ensure that businesses and high-net worth individuals pay their taxes, making this likely to be a 'hot topic' in the months ahead. Whistleblowing – or the threat of whistleblowing – and antitrust concerns are other increasingly common causes of investigations. Generous 'bounties' and legislation protecting their rights have dramatically increased the incidence of whistleblowing and LIBOR and recent changes in legislation and regulation have handed many antitrust authorities significantly increased prominence and powers.

Datoo: For regulated firms, there have been a number of significant fines which have attracted attention and generated senior management anxiety. In addition, the findings and best practice identified in thematic reviews and commentary issued by regulators – speeches made by the FCA, for example – also prompt firms to undertake an internal review where there is sufficient read-across. As a result, firms are more willing to dedicate human and financial resources to begin their own internal investigations promptly and to seek external advice. This helps to demonstrate to a regulator that,

among other things, they are committed to taking a proactive approach, that they take their regulatory responsibilities seriously, and that their systems and controls are effective in spotting issues. In turn, such an approach can help senior managers discharge their obligations under the regulatory regime. Experience suggests that a firm's response to identified issues is a key cultural indicator for a regulator.

CD: Before an internal investigation gets underway, what factors does an organisation need to consider when it comes to selecting an appropriate investigatory model? To what extent is this decision influenced by the nature of the problem and the jurisdiction, or jurisdictions, in which it will take place?

Lavender: There are some things that it is essential to get right at the outset. If the conclusions of the investigation might be put in the public domain or given to a regulator, then it is important to bear that in mind when designing the investigation process. First and foremost, it is essential to establish an appropriate oversight and governance model at the outset. Organisations should ensure that the investigation is set up confidentially, particularly if there is media or regulatory sensitivity. They should also think about the relevant sources of information – documents and people. Firms should also consider whether to start with a 'pathfinder' investigation to scope out the issues. They should also consider if legal professional privilege is to be claimed for the investigation. In some jurisdictions, privilege is not available or only in limited circumstances. They must also consider using an information protocol for the investigation team to ensure that privilege is maintained where possible.

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>
> *Dan Lavender, Macfarlanes LLP*

McCahearty: The first question to ask is whether to investigate at all. Often the answer is obvious but careful thought should always be given, taking account of all relevant factors including obligations to investigate and the implications of discovering unforeseen misconduct. If the decision is taken to investigate, the model should only be determined

after weighing a number of important factors. For example, the purpose of the investigation; the risks and value to the business; the jurisdictions involved and if pre-emptive local advice is needed; the likelihood of litigation or enforcement action and the importance of privilege; data protection and preservation issues, including disabling automatic document destruction systems; and who should be on the investigation team. It is also important to consider external pressures such as obligations to inform regulators and the restrictions they may impose, for example, interviewing witnesses; whether immunity or cooperation is relevant; confidentiality, in terms of deciding who should know about the investigation and how to stop leaks. Finally, it is imperative to manage any conflicts of interest, such as by considering information barriers and sub-committees.

Datoo: A firm's attitude and approach at the start of an investigation is often indicative of its true regulatory compliance culture. A rapid response is important, but equally a firm must avoid the risk of knee-jerk reactions or an inadequate focus and depth to its investigation. Where possible, it is always desirable to undertake a preliminary assessment of the potential magnitude of any issues identified. This may well impact upon the scale, conduct and nature of the investigation. Measures to preserve privilege – particularly if there is the potential for class actions in the US – are an important consideration but there is a balance to be struck. In my experience, measures to preserve privilege may often be overridden by the need to maintain a good relationship with the relevant regulator. However, it is important to have the option. Caution must also be exercised so as to avoid tipping off any 'wrongdoers' as that could compromise the firm's investigation as well as any subsequent regulatory investigation.

CD: What, in your experience, are the main pitfalls that can arise during an internal investigation? What steps can companies take to avoid these issues?

Lavender: One of the most common mistakes is failure to consider the intended audience of the internal investigation's findings – whether documented in a detailed written report, or summarised in a presentation. We often see examples of investigations that are conceived as 'a quick look' or narrow in scope and intended for internal or preliminary use only, but which over time come to have a more detailed or 'public' external-facing purpose. It is important that the scope of the investigation is proportionate and ultimately defensible in the event that an organisation is challenged about its subject matter. Time spent on identifying the real issues and getting the scope right at the start is never wasted. It is also important to have a press strategy developed at the outset – and to be clear what your response to the press will be if,

as commonly happens, the firm is asked to comment on the subject matter of the investigation before it concludes.

McCahearty: Once the decision to investigate has been taken, it is critical to take a step back, seek appropriate advice in all relevant jurisdictions and devise a carefully considered plan for the investigation. Often, a client's instinct when they think they have a problem is, understandably, to find the answer as quickly as possible without always thinking through the most appropriate and effective way of doing so. The most common mistake I see is clients rushing into an investigation and making decisions at the outset which come back to haunt them. Another common pitfall, particularly in complex, international investigations where a number of regulators are involved, is failing to establish clear and 'real time' communications between key advisers in all jurisdictions and the

client. This is not easy to achieve but is crucial to get right.

Datoo: A lack of appropriate governance around an internal investigation is a relatively common pitfall which can prevent the implementation of effective and timely steps in mitigation. For example, we would expect senior management to be kept regularly appraised of material developments during the course of the investigation and have sufficient visibility over the conduct of the investigation. Equally, regulated firms should invest time in proactively managing their relationship with the relevant regulator. It is clearly important that the regulator feels that it is being kept properly and fully informed of key developments. This will sometimes require a degree of judgement on the part of the firm which needs to be exercised in light of all the surrounding factors. Firms also need to be cautious and selective when deciding whether any views expressed by the regulator warrant a challenge. It is important that firms pick the right battles to fight – some will be worth fighting while others will not, in the grander scheme.

CD: In the event of a parallel regulatory investigation, how should an internal investigation be tailored to satisfactorily accommodate concurrent scrutiny?

Lavender: This is one of the most difficult areas. A regulator will often expect full cooperation and frankness, whereas the institution may wish to investigate all relevant facts before giving its conclusion to the regulators. Where there are parallel investigations it is particularly important to have very clear terms of reference and governance. Ideally you would have scoping discussions with the relevant regulator to make sure that there is a common understanding as to the way the investigation will be conducted. It is particularly important to agree how witness interviews will be handled. Some regulators have specific guidelines on this. For example, regulators may ask for transcripts to be made available afterwards or for certain documents not to be put to witnesses who may become the subject of criminal proceedings at a later date.

McCahearty: How you tailor your investigation when there is a parallel regulatory investigation will depend on a number of factors, but principal among them will be regulatory obligations, cooperation to gain credit and litigation risk. These factors will obviously be influenced heavily by the laws, regulations and conventions of the relevant jurisdictions but also by the size and location of any litigation risk. Regulatory obligations are not negotiable and your investigation must be tailored to accommodate them. However, there is often a tension between how much further you go to cooperate and litigation risk. For example, if there

is a significant risk of high value follow on class actions in the US, your view on how much you are willing to share with regulators over and above what is required, including whether you are prepared to waive privilege in all or part of your investigation, may be very different to a situation where litigation risk is low and confined only to continental Europe.

Datoo: A firm's response to regulatory scrutiny is another key cultural indicator from the regulator's perspective. Determining a clear scope for the investigation and regular dialogue with the relevant regulators will likely contribute to an open and cooperative relationship and will hopefully stand the firm in good stead. While an internal investigation is likely to be informative for a regulator, it is not conclusive. Therefore, it is prudent for a firm to be prepared for a degree of regulatory challenge on the methodology and conclusions of its internal investigation. Client-led investigations will frequently seek to anticipate the issues that a regulator might be interested in and seek to progress on a faster timetable. Care should be taken to provide sufficient information to the regulator about the firm's approach on a regular basis and ensure that the regulator is notified of any significant developments as they arise. At the same time, the firm must remain conscious of its ongoing regulatory reporting obligations.

CD: What are the key considerations that investigating parties need to make when interviewing witnesses during an internal investigation?

Lavender: One of the first questions is whether to engage – and pay for – legal representation for the witness. Some regulators – for example, the main financial conduct agencies in the US – prefer companies to pay for independent legal representation so that witnesses will be willing to come forward and cooperate with the investigation. There are also different requirements for witness interviews in different jurisdictions. In the US, for example, it is good practice to provide an interviewee with an 'Upjohn' warning to make sure that they understand that the interviewer acts for the company, so the privilege in the note belongs to the company, not to the individual. The method of recording or writing up interviews is also markedly different in different jurisdictions. Firms should also note that there is a real likelihood that the regulator will request sight of the interview documents – including any preparation papers, documents put to the witness, questions, and the answers supplied – and in the spirit of an open and cooperative relationship it can be problematic for a firm to deny any such access, or even to attempt to.

McCahearty: An increasingly important issue if a parallel regulatory or criminal investigation is ongoing or in prospect is whether the relevant regulators or enforcement agencies object to you interviewing a particular witness, or if they require you to modify your approach. I have been involved in a number of investigations where regulators have imposed a variety of restrictions. These have included not interviewing witnesses until after they have been interviewed by the regulator; not providing witnesses with copies of communications to which they were not party, and not taking any notes of the interview. Failure to speak to regulators before interviewing a witness who may have evidence relevant to a regulatory or criminal investigation risks, at best, irritating the regulator – which will not assist you when you seek to claim credit for cooperation – or at worst, tainting important evidence in a potential criminal prosecution.

Datoo: My key piece of advice to clients interviewing their staff in this context is to put themselves in the shoes of the regulator. Were the FCA to knock on the door, what questions would they want to ask? What questions will they assume you will have asked? Finally, which individuals are likely to be of interest to it?

CD: What advice would you give to an organisation in terms of coordinating the activities of multiple parties, including external experts, who may be involved conducting an internal investigation?

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>
> *Aalia Datoo, Macfarlanes LLP*

Lavender: The first thing to get right is to decide whether the expert is going to fulfil a 'consulting' or 'testifying' role. If the latter, it is important to recognise that in English Court rules, the instructions given to the expert may have to be disclosed to the other parties in the litigation. So care will need to be taken on communications with a testifying expert. It is obviously important to ensure that the expert has available all relevant information and that they are thoroughly briefed. It is vital to make sure the expert really understands the key legal issues.

McCahearty: One of the biggest challenges of large scale internal investigations – especially investigations that span multiple jurisdictions – is the coordination of multiple parties including foreign lawyers, accountants, experts, PR advisers, corporate advisers, data vendors, related parties and their advisers, often multiple regulators in each jurisdiction and key stake holders within the client including different committees and boards, as well as investors. Ultimately, the challenge boils down to making sure information gets to those who need to know within appropriate timescales so that mistakes are not made or opportunities missed while at the same time controlling the information flow sufficiently to maintain efficiencies – both time and cost, prevent leaks and, if appropriate, maintain privilege. Usually, the solution is establishing at the outset a core team of advisers and team members from the client who run the investigation day to day and who are responsible for making sure the appropriate information gets to the non-core team when required.

Datoo: From my experience in regulator-commissioned investigations, which commonly involve a number of stakeholders – for example, remediation work subject to a s.166 (FSMA) Skilled Person appointment – the following ingredients are critical to coordinating an effective investigation or review, and to support the efficient management of multiple parties: clear communication, actively managing expectations of all stakeholders, preserving confidentiality where appropriate, adopting strict terms of reference, and implementing a robust governance framework.

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>
> *Matt McCahearty, Macfarlanes LLP*

CD: Ultimately, what factors define a successful internal investigation? What should companies seek to achieve?

Lavender: This depends on your perspective. The client will – rightly – ask if the investigation was efficient and delivered on budget and on time. A regulator will be concerned to make sure that the investigation is robust and conducted at the right depth. Were all the key data sources searched and

reviewed and all the key witnesses interviewed? Ultimately, I think success is judged in hindsight – does the report stand the test of time and is it useful for the firm? I am also a firm advocate of brevity for reports which are designed to record the findings of an investigation.

McCahearty: Success very much depends on the lens through which you look at the investigation. However, true success is often only achieved when an investigation keeps all of the different stakeholders happy – the lawyers, the client and the regulators. That is not always achievable and, therefore, not a 'fair' measure of success, but it should be the aim. So how do you best achieve that level of success? There is not time in this forum for a full answer but, in my experience, there are three key factors leading to overall success. The first factor is preparation, which is key. It often feels counterintuitive to clients, but taking sufficient time at the outset of an investigation to identify the scope, team, approach, risks and, if appropriate, engage with regulators, pays dividends both in terms of efficiency and results. The second factor is re-evaluation. Unexpected things happen in investigations, dynamics change and, importantly, risks can shift dramatically. Regularly re-evaluating your approach and strategy with the core team to react to those changes is crucial to achieving a successful outcome. The third factor is communication. It sounds simple, but communicating at the right time with the right people – whether that is clients, regulators or members of the investigation team – is fundamental to the success of any investigation.

Datoo: In a regulatory context, a successful internal investigation is one that has identified all relevant issues and their root causes. Similarly, the conclusions drawn once the investigation has been completed need to be robust and defensible. In cases where the outcome warrants remedial action, it is important that clear, practical and adequate recommendations are designed and implemented in a timely manner and that such measures are subject to future monitoring. For a regulator, a critical concern will be whether the issues identified are, or are perceived to be, systemic in nature, and therefore indicative of wider systems and controls issues failings. Ultimately, firms need to ensure that the investigation is robust enough to deter the regulator from initiating its own investigation and thorough enough to withstand regulatory scrutiny. Where non-sophisticated customers are involved, the regulator will be eager to confirm that any customer detriment has been identified and rectified appropriately. CD