

Client Update

UK's Financial Conduct Authority and Prudential Regulation Authority Announce Changes to Enforcement Processes

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OVERVIEW

On 1 February 2017, the UK's financial regulators, the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA"), published a policy statement outlining a number of reforms which are intended to improve the transparency, fairness and speed of their enforcement decision-making procedures. This follows a consultation paper in April 2016 setting out how the regulators proposed to implement HM Treasury's recommendations from a review in 2014 and Andrew Green QC's 2015 report into enforcement actions after the collapse of HBOS.

Many of the changes only apply to the FCA's enforcement process; the PRA will publish a guide to its enforcement process later this year. The substantive amendments affect only guidance issued by the FCA (the Enforcement Guide and the Decision Procedure and Penalties Policy), not binding FCA rules. The policy statement also indicates that there will be further consultation papers in relation to the Enforcement Guide and the FCA's penalties policy. In general, the reforms relating to settlements and references to the Upper Tribunal will come into effect on 1 March 2017, while the remaining reforms are effective immediately. The key changes are summarised below.

REFERRAL TO ENFORCEMENT

The FCA will continue to apply the enforcement referral criteria it published in April 2016, however, it has declined proposals that it should also formulate guidelines as to how it will exercise the significant degree of discretion it holds regarding whether to refer a firm or an individual to enforcement.

The FCA will now publish on its website anonymous examples of cases in which it has decided not to investigate or take enforcement action due to a firm's response to a regulatory breach, particularly where the firm provided significant cooperation to the FCA. In addition, when a firm or individual is referred to enforcement, the FCA or PRA will give them a written summary of the potential regulatory breaches and underlying circumstances, and explain how it applied its enforcement referral criteria in reaching the decision to refer.

SCOPING MEETING

The revised guidance provides that once an investigation has been commenced, scoping meetings with the firm or individual will usually be scheduled when the FCA or PRA investigators are in a position to share their indicative plans on the direction of the investigation and the likely timing of key milestones and next steps. Although this may mean that scoping meetings are held at a later point than was previously the case, the regulators envisage that this will make such meetings more productive and promote dialogue between the parties at an early stage of the investigation.

INVESTIGATION STAGE

The FCA and PRA intend to give periodic updates to the subject of the investigation on at least a quarterly basis, covering the steps taken in the investigation to date, next steps and indicative timelines. To the extent that the regulator is not already in regular contact with the firm or individual, this change is intended to improve communication between the parties.

SETTLEMENT

The FCA will now aim to give 28 days' notice before the Stage 1 settlement period is to begin, so that firms can ensure that key staff will be available to negotiate and approve the settlement. In the intervening period, the FCA will hold preliminary 'without prejudice' meetings with the subject of the investigation to explain the FCA's views, and to allow the firm or individual to indicate the extent to which they agree with the FCA's outline findings and identify any factual errors. However, the FCA's proposed findings and key supporting evidence will normally only be provided at the start of Stage 1, and the FCA retains significant flexibility regarding the form and content of the evidence disclosed to the firm or individual.

In addition, the FCA has set out some factors that may be relevant when it considers an application to extend the Stage 1 settlement period, which is normally 28 days from the date that the FCA issues a 'Stage 1 letter'. Extensions

will only be granted in exceptional circumstances, generally where factors outside the subject's control will have a material impact on their ability to engage in the settlement discussions within the required timeframe.

To address concerns that representations from firms and individuals are not considered or given sufficient weight by the FCA's case team during the settlement process, senior management (the relevant Enforcement Head of Department or a Director) will liaise between the case team and the settlement decision makers and attend a settlement meeting during Stage 1 (or arrange for a senior FCA representative to attend).

Notably, the FCA will introduce a completely new process for resolving partly contested cases before the Regulatory Decisions Committee ("RDC"), with three alternative options available to a firm or individual under a 'focused resolution agreement':

- the subject agrees with the FCA all relevant facts and issues as to whether those facts amount to regulatory breaches, so that the only dispute is as to the sanctions that the FCA intends to impose;
- the subject agrees all relevant facts but wishes to contest whether these facts give rise to liability for regulatory breaches (and by extension disputes the FCA's proposed penalty); or
- the subject agrees some of the issues identified by the FCA but wishes to contest other issues.

Previously, there was no formal mechanism for only part of an enforcement case to be put before the RDC, although this sometimes occurred on an *ad hoc* basis. Under the new procedure, the RDC will decide the sanction to be imposed and any discount applied to the financial penalty, so a focused resolution agreement will not necessarily allow the subject to be eligible for the usual 30% discount for settling at Stage 1, unless only the penalty is being challenged.

Further, the penalty discounts of 20% or 10% which were formerly available for subjects settling cases after the end of Stage 1 will now be abolished. A discount will only be available if the subject settles at Stage 1 (resulting in a 30% discount) or enters into a focused resolution agreement (up to a 30% discount). This will create pressure on the subject of the investigation (especially an individual with limited financial resources) to decide whether they wish to settle the case (or part of it) quickly to benefit from the penalty discount, or battle the FCA in the RDC and Upper Tribunal and risk a substantially higher fine.

REFERENCES TO THE UPPER TRIBUNAL

The FCA will now allow a firm or individual to refer a case to the Upper Tribunal on an expedited basis without involving the RDC, even before the FCA issues a warning notice. This replaces the existing procedure by which, in general, contested cases must first be heard by the RDC before a decision notice is issued which can then be referred to the Tribunal.

ANALYSIS

The reforms announced by the FCA and PRA are broadly to be welcomed and should enhance the transparency of the enforcement process for firms and individuals. Those subject to investigations often feel that they are not provided with sufficient information regarding the investigation's progress, the regulator's views of the case, or the key evidence for and against them (such as transcripts of interviews which their lawyers were not permitted to attend), and that their reasonable arguments are not properly considered by the regulator. These reforms go some way towards addressing such concerns.

However, a great deal depends on how the guidance is applied in practice. Indeed, many of the changes simply reflect existing good practices by FCA case teams, which have not previously been codified. The additional guidelines should help ensure that case teams take a more consistent approach across different matters. Firms and individuals should consider how they can deploy this guidance to their advantage in dealing with the FCA and PRA during regulatory investigations.

The most significant and interesting change is the introduction of a new procedure for resolving cases in which only some of the issues are in dispute. Although some difficulties are likely to arise, this process could help resolve some cases at an earlier stage, at a lower cost and more fairly for the subject of an investigation. It also appears likely to encourage more firms and individuals to contest parts of their enforcement cases at the RDC.

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Please do not hesitate to contact us with any questions.