Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Never Mind The Brexit: FCA Sets Real Priorities For The City

By **Mark Taylor**

Law360, London (April 19, 2017, 9:56 PM BST) -- Lost in the melee of Tuesday's U.K. surprise general election announcement was the Financial Conduct Authority's grand plan for the coming years, and experts have warned firms cannot afford to let politics distract them from immediate compliance and culture questions or use it as an excuse to hide misconduct.

The FCA published its business plan, a sector view outline of risks it observes and its "mission" statement, a mark of intent by Chief Executive Andrew Bailey to remold the regulator into a more efficient, consumer-friendly beast as it juggles a new role helping the government deal with Britain's decision to leave the bloc.

There were no nasty surprises, said Charlotte Hill, partner at Covington & Burling LLP, but instead sure signs that the watchdog, with one eye on Brexit, will be looking to ensure banks remain diligent while the sector endures at least two years of significant turbulence.

"We once again see the regulator focusing on firms' culture and governance," Hill said. "The FCA has found poor cultures in firms, driving inappropriate outcomes; strategies, business models and governance arrangements that are not aligned with good conduct; and incentives that do not encourage the right behaviors."

The regulator has increasingly targeted these areas in different sectors of the market for some time, with the Senior Managers and Certification Regime, or SMR, placing individual accountability around the neck of top executives. This will be extended to all firms in the financial sector from 2018, and the FCA hints that the focus of its supervisory work carried out through visits will be on ensuring uncertainty elsewhere is not breeding bad behavior.

"Given the FCA's longstanding focus on corporate governance and culture, there are no surprises here, but firms would do well to consider how their culture and corporate governance has been amended and improved in order to implement the SMR — and just how well the regime has been imbedded," Hill said.

The U.K.'s decision to leave the European Union was deliberately omitted from the initial mission consultation announced in October, but events since have conspired to put it on top of the FCA's agenda.

Bailey said FCA lawyers are currently poring over the EU's financial sector laws to ensure smooth transition into British legislation following Brexit, as per the Great Repeal Bill drawn up by Prime Minister Theresa May. The agency also promised to work with its counterparts in EU states, watching for firms that could develop complex business models in an effort to gain access to the 27 remaining countries in the EU.

"Interestingly, one of the post-Brexit questions is the extent of ongoing intelligence sharing between European enforcement agencies," said Jeremy Summers, business crime partner at Osborne Clarke. "Retaining the current level of cooperation will be vital to the FCA going forward in this and many other areas."

With 56,000 firms and 140,000 individuals under its regulatory oversight in the financial services sector, which employs more than 2 million people, the FCA has a central role in ensuring London remains the European capital of finance and a major global player with all that is now going on.

"The U.K.'s decision to leave the European Union creates uncertainty for both the U.K.'s financial industry and the FCA," said Bailey, former deputy governor of the Bank of England. "The U.K.'s withdrawal from the European Union will have important implications for the FCA over the coming years."

Increasingly uncertain markets often cause culture problems to be shaken out, according to Richard Abbey, a forensic partner in the Ernst & Young LLP fraud investigation and disputes service, and the FCA will be scrutinizing the sector to ensure Brexit or the forthcoming election are not used as conduits for crime.

"Over the last 18 months, we have had the EU referendum, U.S. election, fluctuations in commodity prices and exchange rates," he said. "Volatility creates uncertainty, and in the past, this is where we have seen fraudulent issues arising."

An early test of Bailey's leadership and the credibility of the SMR could arise from the current investigation into Barclays PLC and its chief executive over the handling of a whistleblowing incident. The FCA and the Prudential Regulation Authority are probing an attempt by CEO Jes Staley to identify the author of a letter that was treated by the bank as a whistleblowing incident in 2016.

When pushed on the strength and significance of the whistleblowing regime on the back of the Barclay's investigation, Bailey said: "We rely on whistleblowers as an important channel of information. We take it very seriously."

How seriously the FCA really takes the issue is up for debate, lawyers said. On the surface, according to the business plan, very much so as it lays out a renewed vigor to tackle money laundering and economic crime and will put in place support for whistleblowers and provide them with anonymity.

“This is interesting in the context of a proposed amendment to the Criminal Finances Bill,” Hill said.

The bill's new clause on whistleblowing, potentially to financially compensate whistleblowers in specific institutions, applies when the fine resulting from the whistleblowing is not less than £500,000 ($639,400).

“Unsurprisingly, the FCA makes no mention of this or of its views on it,” Hill said. “Should this amendment go ahead, it will be interesting to see how the FCA deals with it as it would fly in the face of the FCA’s ethos with regards to these matters.”

Lawyers are also anticipating a forthcoming consultation on the use of private warnings, as indicated in the business plan. Private warnings are a nonstatutory tool used by the FCA to put a person on notice that a breach may have occurred, but for whatever reason, formal action will not be taken on the particular occasion. Details are not made public, and the individual cannot fight it unless they take the matter to court.

According to data published by the FCA, the agency has not issued any private warnings since the SMR came into force in March 2016, and one lawyer with knowledge of the matter who asked not to be named told Law360 they are likely to be dropped entirely.

“In our view, private warnings have a place in the FCA’s enforcement toolkit and in certain circumstances is a proportionate and appropriate alternative to formal action,” said Louise Hodges, criminal litigation partner at Kingsley Napley LLP. “To curtail their use entirely would be a mistake.”

Hodges said if the FCA has concerns about transparency, “then perhaps there should be a concerted effort to promote an understanding of the role and purpose of these warnings” rather than seeking to limit their use.

The FCA has also been accused of issuing the private warnings seemingly at random and with little or no warning.

“The proposed consultation should clarify these issues,” Hill told Law360. “However, such clarification, whilst welcome on one level, may not work to the benefit of firms but depending upon how it is implemented, actually may make it easier for the FCA to issue such warnings.”

With its role in Brexit to contend with alongside its role of advising the government and assuaging industry concerns, anything that makes the FCA’s life easier is likely to be welcomed. The regulator announced in its fees update it would be setting an extra £2.5 million in its budget aside to cope with issues concerned the U.K.’s departure from the bloc.

“Many will be asking if the £2.5 million Brexit budget announced matches the enormity of the task,” said

Fiona Fry, head of KPMG International’s Regulatory Centre of Excellence. “The FCA already has a lot of important work on its plate so any shift in its priorities to accommodate Brexit will be challenging to execute.”

Keeping the U.K. market at the forefront of its priorities is a main goal, however, and Fry, along with Summers, pointed to the FCA's emphasis in its plan on “cooperation between regulators” and maintaining “consistent global standards.” This shows the regulator acknowledges the fate of the U.K. market is not completely within its own control, Fry said.

Additionally, the potential ramifications of a general election taking place on June 8 should not be overlooked.

“Whatever the outcome, the FCA will have two years to ensure the U.K. financial market remains stable and strong as we prepare to play an independent role in the global economy,” Fry said. “The FCA’s business plan will hopefully form a reliable bedrock for that work.”

--Additional reporting by Richard Crump. Editing by Christine Chun and Emily Kokoll.