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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

FCA Ramp-Up Risks Cooling City Investment By Financial Firms

By **Mark Taylor**

Law360, London (July 11, 2017, 11:12 PM BST) -- The U.K. Financial Conduct Authority's aggressive pursuit of enforcement investigations amid Brexit negotiations has unsettled City talent and may even deter investment, top white collar attorneys warn, risking further damage to London's future as a financial center.

The FCA's head of enforcement, Mark Steward, told Law360 in an interview last week that the regulator is trying to break with its previously conservative approach and has become bolder in identifying and chasing misconduct.

He said that with the new market abuse regulations to uphold and more tools to use, he wants to see more investigations, concluded faster than before.

The FCA and its predecessor, the Financial Services Authority, have been slammed by the government for their weak handling of issues such as market-rigging and high-profile failings, including the near collapse of HBOS PLC bank, which led to a £11 billion ($14.1 billion) taxpayer bailout.

"They had criticism they were taking 'easy' cases, or were very cautious in what they investigated, and perhaps it meant they weren't getting as much coverage [of the market] as they should be or getting to the bottom of certain issues," said Joanne Stephens, attorney at Kingsley Napley LLP.

According to Steward, the FCA has been chastened by the criticisms that it was too slow to act and overly selective in past cases, and it is now determined to make full use of its powers.

But lawyers say this is a dicey approach, noting the danger in painting London as a draconian state for financial services firms at a time when many are seeking to flee the City as a consequence of Brexit and the less favorable regulatory climate.

It is a very delicate balancing act for the regulator to try and strike, according to Stephens, who said the FCA's tough approach may "send out a message to investors that it is dangerous to be involved in the market."

Here, Law360 looks at why the FCA may want to consider softening its aggressive enforcement stance.

Casting Too Wide a Net May Damage Credibility

Last year was the FCA's busiest, with 213 investigations — more than double the previous year's 97. And a Freedom of Information request by Law360 revealed that the regulator is heading for another record year of enforcement activity, carrying out 126 probes into firms and individuals by May 1, just seven short of its entire number for 2012 and more than any other annual total except last year.

But the number of cases it has dropped is higher than in previous years: In 2016-17, 62 percent of the total cases were closed with no further action being taken, up from 33 percent in 2014-15.

An FCA investigation can be an extremely serious matter for a firm or an individual, said Robert Amaee, partner at Quinn Emanuel Urquhart & Sullivan LLP, with potentially damaging financial and professional consequences regardless of the outcome.

According to Amaee, "the FCA's most recent Annual Enforcement Account suggests while the number of investigations has increased, a significantly higher percentage of cases are now ending up with no further action, but not before the firms or the individuals have incurred the costs and distraction of dealing with the matter."

Attorneys question whether quantity of investigations is really what the FCA should be focusing on.

"There is arguably very little benefit in the FCA continuing to focus on the low-hanging fruit," said Claire Cross, of counsel at Corker Binning. "In order for them to remain as credible enforcers, they must clearly aim higher up the tree."

She said this will undoubtedly result in less surefire wins, but good enforcement agencies must be prepared to lose sometimes.

"To do otherwise results in a weak and ultimately toothless watchdog," Cross said.

She said Steward's suggestion that the FCA would be willing to cull cases at an earlier stage would be welcomed, but the regulator must demonstrate it is mindful in choosing which cases to open, and that a "lackadaisical or slap dash approach" knowing it could cut and run would be unhelpful.

"If the suggestion is that the FCA is looking to increase the number of investigations at least partly by applying a lower threshold and being less selective, then that is of concern to all those who are regulated by the FCA," Amaee said.

Even a Fruitless Investigation Can Do Harm

"An FCA investigation can be an extremely serious matter for a firm or an individual, and can have damaging financial and professional consequences whether it results in a sanction or not," said Amaee.

The FCA may need to send a message that misconduct will not be tolerated, but even investigations that go nowhere risk meddling with the lives of individuals who may unwittingly be swept up in them, according to Stephens.

Individuals investing in AIM, the London Stock Exchange submarket for smaller, less-viable companies which has a more flexible regulatory system, could be put off by thinking their every action is much more likely to be investigated.

“That is not great for the economy — it’s important to have that level of investment and exposure,” Stephens said.

Steward told Law360 that while he expected the FCA’s year-old Senior Managers and Certification Regime would result in more cases, he wanted law firms advising those under the spotlight not to treat the new wave of activity as “pre-litigation.”

Steward’s aim may be that the stepped-up enforcement is seen merely as “fact-finding,” Cross said, but “ultimately, being investigated for any form of alleged misconduct carries a large stigma for the person, or firm, under investigation.”

And for individuals unfamiliar with the FCA’s approach to investigations, the experience can be frightening as well as costly, according to Charlotte Hill, financial services partner at Covington & Burling LLP.

Individuals will receive a letter informing them they are under investigation, accompanied by questions from the FCA. They are instructed not to throw any papers away. This first letter is likely to be followed by further demands for information, as well as requests to attend an interview.

“Sensible people take a lawyer with them, as a lot of the questions asked can be quite leading,” Hill said. “They can be long interviews, and are probing.”

Individuals are given a copy of recordings to check, and then given the chance to comment, but the FCA holds all the cards in the process until it makes a decision. City workers who move firms can also get the letter at their new job for an incident that happened at their old firm.

“Again, there is the question of informing the new employer,” Hill said. “It may even lead to someone being sacked on the spot — even though later, it turns out that the FCA’s claims are unsubstantiated.”

Some of the current enforcement cases in the works include examples of managers accused of companywide failings happening on their watch.

Under the SMCR, a conduct program to which the biggest banks and insurers are beholden, there is more emphasis on senior individuals to be accountable, and the FCA has less tolerance for mistakes, Hill said.

Soon the SMCR will be widened to the financial services market as a whole, pulling in fund managers and thousands of other operators, and lawyers expect investigations into individuals to soar again as a result.

“The FCA will want to show at quite an early stage that they mean business,” Hill told Law360. “With new areas of the market being covered by the regime, they don’t want any ideas that it will be easy to comply with, that the FCA will be lenient, having seen no previous actions.”

It will also sweep up much smaller firms who may not have resources to deal with all this effectively, Hill said.

The Regulator’s Own Resources Are Limited

The FCA is already stretched thin, lawyers say, and widening its net could put unnecessary pressure on itself and the firms it regulates, creating a hostile and unwelcoming environment for talent and big international investment firms.

In the FCA's annual report published last week, Steward was adamant that while many probes will end without charge, it will not stop the agency from pursuing all available leads — but did not elaborate on how the agency will accomplish that task.

"From the FCA's own perspective, it is also not entirely clear that it will have the necessary resource and expertise to deal properly with any exponential rise in new investigations and all the associated challenges that this new approach will bring," Amaee said.

According to Alison Geary, counsel at WilmerHale, the increased workload on investigators will undoubtedly slow progress and won't benefit anyone.

"With only finite resources, the FCA risks writing checks it cannot cash," she said. "Problematic conduct will take longer to come to light, firms will have more compliance resources tied up dealing with historical conduct and many individuals will be left for long periods without a livelihood."

--Editing by Rebecca Flanagan and Emily Kokoll.
