

LOOKING FORWARD: THE FCA ENFORCEMENT TRENDS FIRMS CAN EXPECT IN 2022 PART 1

Date: 5 April 2022

UK Litigation and Dispute Resolution Alert

By: Michael E. Ruck, James Jago

EXECUTIVE SUMMARY

- As the Financial Conduct Authority (FCA) attempted to mitigate the effect of COVID-19 on consumers and the market, enforcement investigations and action slowed.
- 2021 saw a pledge from the FCA to become more “forward-looking” and “proactive,” coupled with a resurgence in enforcement capacity and activity.
- In 2022, firms are likely to see more enforcement activity in areas such as financial crime, retail misconduct, and market abuse.
- Firms should be particularly mindful of their systems and controls in relation to retail misconduct, as potential redress claims could dwarf any fines imposed by the FCA.

CHANGING FOCUS AFTER 2020

The FCA published its 2020/21 Business Plan on 7 April 2020. The FCA made clear that its focus was on mitigating the effects of COVID-19 on the markets and protecting customers in this regard. The FCA even confirmed that it would only focus on other regulatory areas where this would not dilute their efforts to ease the impact of COVID-19.

A year later, the FCA publicly acknowledged that the pandemic had slowed down the progress of some of its enforcement investigations. The 2021/22 Business Plan pledged that the FCA would turn its sights to becoming a more “forward-looking” and “proactive” regulator, noting that this would involve three distinct changes: becoming more innovative, adaptive, and assertive.

THE FCA IN 2021

Throughout 2021, the FCA followed through on its pledge and imposed just over £567.7 million in financial penalties on seven firms and three individuals. This put financial penalties at their highest level since 2015. At the end of Q3 in 2021, the FCA had 603 open enforcement investigations. This figure was only slightly lower than in 2019 (650) and 2020 (646), despite the fact the number of new enforcement investigations opened across the previous two years dropped significantly (53% fewer than in 2018 and 2019).

The majority of the £567.7 million was made up of penalties imposed in December 2021, including the landmark decision against Natwest for anti-money laundering failures. The charges covered Natwest's failure to properly monitor the activity of a commercial customer, Fowler Oldfield, a jewelry business based in Bradford. Natwest admitted their failure to appropriately supervise a customer's account, which enabled money laundering of £365 million. This conviction represented the first criminal prosecution under the Money Laundering Regulations 2007. Firms can expect that it will not be the last, with the case clearly signaling the FCA's increasing appetite to prosecute anti-money laundering offenses.

ENFORCEMENT IN 2022 AND BEYOND

Now that the FCA is returning to the enforcement capacity shown prior to the COVID-19 pandemic, there are a number of areas in which firms can expect to see enforcement activity in 2022.

FINANCIAL CRIME

Financial crime continues to be a key area of focus for the FCA; in 2021, half of the financial penalty notices that the FCA issued were imposed for issues relating to firms' financial crime systems and controls.

Most of the FCA's enforcement action relating to financial crime has been based on FCA Principle 2 (firms must conduct business with due skill, care, and diligence) and Principle 3 (firms must take reasonable care to organize and control affairs responsibly and effectively, with adequate risk management solutions). More than half of the cases in 2021 where the FCA took enforcement action highlighted weaknesses in "Know Your Customer" policies and procedures. Through enforcement action, the FCA has also been critical of a number of other mechanisms, including the identification of red flags, assessment and mitigation of financial crime risks, financial crime policies and procedures, and record keeping and prioritization of financial crime risk mitigation.

The FCA is additionally taking a stronger and broader approach to how it uses its enforcement powers in relation to financial crime issues. In October 2021, the FCA applied Principle 3 in a prudential context to a firm's unregulated activities, as it fined a number of companies in the Credit Suisse Group. The fines were imposed for financial crime failings, including breaches of Principle 3, in relation to unregulated corporate lending. The use of enforcement powers in this manner recognizes the potential impact these unregulated activities may have on a firm's regulated business and more widely on the integrity of the UK financial system. It is likely the FCA will continue to stretch the use of its enforcement powers to cover unregulated activities as well as regulated activities in 2022.

RETAIL CONDUCT

Just under one-third of the FCA's enforcement caseload is made up of cases involving potential retail misconduct. In 2020, over half of the cases where the FCA took enforcement action involved retail issues.

In 2022, it is likely there will be a steady flow of FCA enforcement action in this area. There are currently a high number of open investigations, and the FCA has a clear focus on problems affecting retail customers; in the 2021/22 Business Plan, the FCA stated that it wants firms to "consistently focus on consumer outcomes so that customers can make decisions in their interests."

In particular, the FCA continues to center its efforts on customer communications, as the FCA remains concerned about their quality and appropriateness. The FCA has taken issue with the adequacy of documents used by customer-facing employees, the quality and frequency of training that firms give to these employees, and the accuracy of statements made in written customer communications.

In terms of regulatory enforcement, the largest penalty imposed in 2021 was £90.7 million. Lloyds Bank General Insurance and other group companies were ordered to pay this sum for breaches of Principle 3 and Principle 7 (firms must communicate information in a way which is clear, fair, and not misleading) in relation to home insurance renewal letters. Some renewal letters stated that renewal was at “competitive pricing” without steps being taken to check this was accurate, and some renewal letters purported to apply a discount that was not available. In both cases, the FCA found that the wording was unclear, unfair, and misleading.

The FCA is also focusing on enforcement regarding the treatment of vulnerable customers. In October 2020, the FCA conducted research which found that 27.2 million individuals—over half of all UK adults—displayed signs of vulnerability. Later that year, the FCA fined Barclays Bank UK PLC, Barclays Bank PLC, and Clydesdale Financial Services Limited £26 million for failures in relation to their treatment of consumer credit customers who fell into arrears or experienced financial difficulties.

The FCA is taking into account ever broader considerations when dealing with vulnerable customers. In 2021, the FCA took action against Credit Suisse for serious financial crime due diligence failings around loans worth over US\$1.3 billion, which the bank arranged for the Republic of Mozambique in relation to infrastructure projects. Notably, the FCA considered that the propensity for financial vulnerability in the general population of Mozambique was an aggravating factor.

Where a firm is found guilty of retail misconduct, there can be a sizeable dual impact; aside from the financial penalties, which the FCA may choose to impose, the cost of customer redress is ever increasing. Since the start of 2018, firms that have been subject to FCA enforcement action for retail issues have also paid out almost £1 billion in redress to customers. This dwarfs the financial penalties that the FCA has imposed, and it makes it even more important that firms continue to ensure all retail conduct is up to standard in the coming year.

MARKET ABUSE

The FCA's number of open market abuse cases has steadily decreased since 2018/19. In the last two years, the FCA has only taken enforcement action for market abuse in four cases. Despite this, at the end of 2021 the FCA did publish a number of warning notices making clear its intention to take enforcement action against several individuals for market abuse. The FCA has also recently concluded its first prosecution under the Financial Services and Markets Act 2012 regarding making misleading statements to the market.

One area that may see significant enforcement action is “personal account dealing.” The FCA has observed notably higher levels of personal dealing since the onset of the COVID-19 pandemic. Suspicious personal account dealing is likely to be probed by the FCA, and there is also likely to be further scrutiny of firms' controls in this area. This would include how they monitor and take action in relation to any failure by employees to adhere to these controls.

HOW WE CAN HELP

The requirements of the ever-evolving regulatory regime may lead firms to believe that it is almost impossible to be compliant and remain up to date. However, firms and senior individuals with responsibilities in this area can do much to protect themselves. K&L Gates is equipped to advise on the full suite of regulatory and criminal issues, including nonfinancial misconduct, and can offer clear practical advice on how best to meet FCA requirements in this fast-moving regulatory environment. The touchstone of our practice is to offer industry-focused and client-led solutions from the preparation of adequate controls to full-scale investigations should any potential wrongdoing arise.

KEY CONTACTS



MICHAEL E. RUCK
PARTNER

LONDON
+44.20.7360.6424
MICHAEL.RUCK@KLGATES.COM



JAMES JAGO
ASSOCIATE

LONDON
+44.20.7360.6416
JAMES.JAGO@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.