

## Why City Firms Must Brace For Wave Of FCA Investigations

By **Mark Taylor**

*Law360, London (May 31, 2017, 8:24 PM BST)* -- Investigations into failings at the heart of Britain's financial sector soared in 2016 and don't appear to be slowing down any time soon, prompting lawyers to warn firms that regulators may look for any excuse to come knocking.

A Law360 freedom of information request reveals that the Financial Conduct Authority had already carried out 126 probes into firms and individuals from January through May 1.

Last year, the agency's busiest, it carried out 213 investigations — more than double the previous year's 97. This year's total so far trails all of 2012 by just seven investigations, and it exceeds every other annual total.

"If the FCA continues at this rate, it will open about 300 formal investigations this year, and that will be the highest number for some time, if not, all time," said Chris Finney, financial services partner at Fox Williams LLP.

There has been redoubled focus on money laundering, market abuse, the appointment and oversight of appointed representatives, and the conduct standards in and of consumer credit firms, independent financial advisers and insurance brokers in particular, Finney said.

"Each of these things increases the risk of a formal investigation — and it increases the risk for individuals more than it increases the risk for firms," said Finney, a former lawyer in the general counsel's division at the FCA's predecessor, the Financial Services Authority.

Since FCA Chief Executive Andrew Bailey took the reins in July — following a leadership wobble in which his predecessor Martin Wheatley was fired — he has attempted to right the ship at the agency.

Weeks after the former Bank of England executive assumed the role, he said at the FCA's annual public meeting that "a crisis of financial conduct ... has had damaging consequences for the economy and society."

### FCA Poised For Record Year

Year	Investigations
2012	133
2013	85
2014	105
2015	97
2016	213
2017, Jan 1. to May 1	126

"Out of this experience we must establish and embed the mission of the FCA, and give it the much-needed underpinning," he said. "For me, the challenge is to get the FCA firing on all cylinders and by doing so support the public interest and the people of this country."

Under his watch, a number of significant enforcement actions have occurred.

The regulator worked with the Serious Fraud Office earlier this year to pursue British retailer Tesco PLC in a landmark case after the company was alleged to be distorting the prices of its shares and bonds with false accounting.

Tesco must pay more than £85 million (\$109.6 million) in compensation to investors as part of the deal worked out with the FCA, the first example of the agency obtaining compensation from a listed company for market abuse.

The watchdog had not before used its powers, as it cited Section 384 of the Financial Services and Markets Act, to require a listed company to pay compensation for market abuse.

In January, it levied a record £163 million fine against Deutsche Bank AG for money laundering failings. The agency's first fine of the year followed months of warnings that it was stepping up its campaign to root out dirty money from the U.K. banking system.

Unlike its predecessor, the FCA also has competition powers and is becoming increasingly active in the antitrust field, pursuing two major actions in as many years.

The enforcement pendulum also appears to be swinging away from firms and onto individuals in relation to insider trading, accounting for the rise in investigations, said Guy Wilkes, financial services and white collar partner at Mayer Brown International LLP.

In April, the FCA announced it is reopening an investigation into the events surrounding a £245 million loan fraud at HBOS PLC, almost a year after lawmakers slammed the regulators for failing to hold senior management at the bank to account for negligence that resulted in the bank's collapse in 2008.

The criticism stung the FCA and even resulted in calls by politicians for the regulator to be broken up as penance for its role in the HBOS debacle.

According to Wilkes, the FCA has made "a number of changes in [its] approach to investigations" following a review into the HBOS probe.

Bailey is overseeing the widening of the oversight of the U.K.'s senior managers and certification regime, or SMCR, a program by the FCA and banking regulators to put top executives liable for regulatory or even criminal sanctions for failures occurring under their watch.

"Recent figures showed that there are currently 11 SMCR-related cases against individuals working their way through the system," said David Berman, financial services partner at Quinn Emanuel Urquhart & Sullivan LLP. "One might expect these numbers to increase materially once the SMCR is rolled out beyond banks and insurers."

This intent to hold senior individuals to account may be linked to the criticism the FCA received for

HBOS, said Rachel Couter, financial regulatory disputes partner at Osborne Clarke.

“Given the fanfare with which the SMCR came into force over a year ago, clearly there will be some pressure on the FCA to bring an enforcement action for breach of the new statutory duty of responsibility,” said Elly Proudlock, white collar counsel at WilmerHale.

The SMCR was born of a cultural shift toward individual responsibility, Proudlock said, and even if the spike in investigations is not the direct product of the regime, the underlying cultural shift is likely to be a cause.

It is another tool, and the FCA is not shy at flexing muscles, putting individual accountability near the top of its hit list, said Berman, author of the book “Senior Individual Accountability in the Financial Services Area.”

“The SMCR equips the regulatory authorities with some invaluable new tools — most obviously a senior manager’s statement of responsibility,” he said. “In principle, this should make it easier, evidentially, for regulators to establish the requisite evidential link between senior individual and regulatory contravention.”

Next year the SCMR will be extended to asset managers, financial advisers and stock brokers, which is also likely to have an impact.

“We might therefore expect to see a discernible rise in the number of investigations and enforcement actions being brought against senior-level individuals,” Berman said.

Lawyers say the freeing up of resources following major investigations into wrongdoing within the foreign exchange markets and benchmark rigging are also likely to be a major factor in the rise in investigations.

After fining Citigroup Inc., HSBC Holdings PLC, JPMorgan Chase & Co., the Royal Bank of Scotland Group PLC and UBS AG a British-record-breaking £1.1 billion for forex manipulation in late 2014, the FCA launched an industrywide program to ensure firms addressed the root causes of the problem, tasking senior management with proving that changes had been made.

“From a criminal perspective, I think what we saw in 2015 was significant resource directed to the forex probe,” said Jeremy Summers, white collar partner at Osborne Clarke. “That having now been concluded, the FCA is redirecting resources back to criminal investigations such as alleged insider dealing.”

Last year, the FCA said more than 30 firms representing around 70 percent of the U.K.’s foreign exchange market showed marked improvement after starting the “remediation program.”

Following the introduction of a voluntary global code of conduct for the forex market last week, the regulator said it will step in to enforce it, linking it to the U.K.’s own manager accountability rules for bankers operating in London.

A new chief executive and more tools in its belt may be helping to drive the FCA’s probes, but lawyers say the agency is also becoming bolder and less choosy about the formal investigation process itself.

“There may be an increasing willingness on the part of the FCA to initiate investigations, even if they are subsequently dropped due to a lack of evidence or the issues are resolved without recourse to enforcement action,” Proudlock said.

Bailey’s mission statement emphasizes the importance of enforcement investigations as a diagnostic tool and that they will not automatically assume “a sanction is inevitable or even likely,” Couter said.

The FCA's willingness to initiate investigations tallies with the appointment of Mark Steward as director of enforcement and market oversight in October 2015, and lawyers say this is no coincidence.

“His modus operandi appears to be to open as many investigations as possible, whereas previously the FCA would only have opened an investigation if it had a suspicion that a regulatory breach might have occurred,” Couter said.

In previous years, early investigative steps and assessment were often undertaken prior to the formal appointment of investigators, Wilkes said, usually as a means of focusing resources on the most serious or most important cases.

“There was also a recognition within the FCA that appointing investigators, even if the investigation ultimately leads nowhere, can cause serious detriment to the firm or individual under investigation whilst the investigation is ongoing,” Wilkes said.

Bankers were often suspended, or faced substantial legal costs, making it impossible to move jobs within the industry during the period of investigation, leading the FCA to act only where the evidence was reasonably strong.

This attitude has now changed, lawyers say.

“The FCA’s current practice is to formally appoint investigators much earlier in the process, very soon after it first becomes aware of circumstance that might indicate wrongdoing,” Wilkes said.

There are downsides to the FCA’s new approach: The agency has acknowledged that this will result in a far greater number of cases being dropped without formal enforcement, leading the FCA to face a dramatic rise in legal costs.

The agency may also have to answer awkward questions about its aggressive approach if it fails to deliver on expectations set by the government and public.

“This isn’t something we would be able to comment on at this stage, as we will be publishing our annual review in July, which will include our enforcement stats and comments,” the FCA said in a statement to Law360.

There are also staffing issues to address, lawyers say.

“The significant uptick in the number of investigations has not been coupled with a commensurate increase in headcount or resources within enforcement,” Wilkes said. “Whilst the number of investigations commenced has significantly increased, the number of enforcement outcomes has decreased.”

He said there is a concern within the sector that mounting investigative workload is slowing down investigations and could lead to unfairness for individuals under investigation for extended periods.

The upshot for financial services firms will be increased dealings with the FCA, and lawyers are advising clients to get used to being contacted and to take action immediately once an investigation is started.

“It is more difficult to change the investigator's' perspective of a particular set of facts than to ensure that the investigator's perspective is the right one in the first place,” Couter said.

This concerns directing resources to areas the FCA is aiming for, Finney said.

“As always, with these things, it's not just about what you do and do not do,” he told Law360. “It's also about how well you document your activities, and your reasons. So clear, detailed record keeping is also essential.”

--Additional reporting by Alex Davis, Melissa Lipman and Richard Crump. Editing by Rebecca Flanagan and Brian Baresch.