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So Far So Good For FCA's Little-Used Settlement Process

By **Richard Crump**

Law360, London (May 13, 2019, 6:56 PM BST) -- Even though the Financial Conduct Authority only used its partial settlement process for the third time in April, attorneys say the system is proving to be a success for individuals and companies facing disciplinary action from the watchdog.

Standard Chartered PLC, mobile retailer Carphone Warehouse and broker Linear Investments have all recently used the regime to challenge large financial penalties from the regulator while remaining eligible for a discounted fine, overall making rare use of a process established in 2017.

Each of the attempts to whittle away at the size of the sanction ultimately failed. But Syedur Rahman, senior associate at Rahman Ravelli Solicitors, said the system has “proved a happy middle ground” for businesses or individuals that had previously faced a simple choice when in the FCA’s crosshairs.

“Either you settled everything or you contested the whole case,” Rahman said.

Before the FCA laid out the route to partial settlement, anyone facing disciplinary action had to either admit to all the watchdog's allegations — even if they neither accepted nor denied any of the claims as they sought to gain a healthy discount on the fine — or contest the whole case and risk a more draconian sanction.

“Historically, there was a problem with some firms, in some cases, seeing the process as artificial," said Chris Chapman, a partner in Mayer Brown’s dispute resolution and financial services regulatory and enforcement practices. "There was a perception that once an investigation started it was hard to avoid a public sanction, which the FCA could use as an example for the industry.”

Many of those facing disciplinary action were reluctant to challenge the watchdog through its independent board, known as the regulatory decisions committee, or RDC, which meant the regulator could roll out whatever sanction it liked.

“Clients did not want to disagree with the FCA enforcement team in front of the RDC or the Tribunal, but now there appears to be more scope to do that. The FCA has shown, publicly and privately, that it is happy for firms and individuals to use the Regime in appropriate cases," Chapman said.

And companies appear to have become bolder. In the most recent case, the regulator fined Standard Chartered £102 million ($133 million) for having poor anti-money laundering controls. The fine was the second-largest financial penalty for AML controls ever imposed by the regulator and would have been £43 million higher had the bank not qualified for a 30% discount.

Standard Chartered did not dispute the FCA's findings. It used its right, under the partly contested case process, to ask the watchdog's RDC to assess the appropriate level of sanction.

Critically, those in the FCA's firing line can now protect their discounted fine while still "being heard on the facts" by the committee, according to Richard Burger, a London-based partner specializing in financial services and corporate crime at DWF Law LLP.

"Having an opportunity to agree a particular set of facts while being able to challenge the fine and contest other issues can be very meaningful," Burger said. "How a case is reported is of huge significance to firms."

Investors will also want to preserve as much capital as they can for the business. Burger said companies now get a "free bite at some of the facts," knowing they will retain some or all of the discount through a sliding scale.

The scale ranges from 30% if they agree with all facts and alleged breaches, between 15% and 30% if they agree all the facts but not all the breaches and between zero and 30% if they reach a more limited deal with the FCA.

"Companies are very conscious that the financial penalty comes from the profit of the business," Burger said. "There has always been sensitivity to not lose the 30% discount. If a firm using the process has locked in the discount it will be more likely to roll the dice on some of the facts."

Mark Steward, the FCA's head of enforcement, said in a recent speech that the new, optional route avoids a deal-making approach, in which companies admit guilt to gain a discount.

It also provides a mechanism for the RDC to be engaged more frequently and gives companies and individuals the opportunity to challenge the FCA's penalties. Stephen Elam, a partner at Cooke Young & Keidan LLP, said the change came about because Steward was more prepared than his predecessors to drop bad cases.

"Steward has a direct approach and that comes alongside this regime," Elam said. "It shows the FCA is serious to allow firms to challenge its decisions in appropriate cases."

But change could take time, Elam suggested.

"While challenging sanctions will continue to be the trend, I think — as much as the FCA likes to say otherwise — you will be stuck with a somewhat transactional approach," he said.

In principle, any matter relevant to the proposed enforcement action can be agreed. These can include questions of fact, whether specified facts amount to a breach, the appropriate level of financial penalty and whether action for a suspension, restriction or limitation is warranted. But the three companies to have used the partial settlement process have conceded all the facts in the case and contested only the penalty.

The first case to be completed involved Carphone Warehouse, which was fined £29.1 million ($37.9

million) for misselling insurance and technical support products following reports from whistleblowers. Like Standard Chartered, it kept its 30% discount because it did not dispute the findings that it had wrongly sold policies.

While it was clear that the British phone giant had made mistakes, the final outcome shows what scope there is for obtaining a lesser penalty if negotiations are handled correctly, said Rahman.

But businesses cannot assume that such a process will always make it possible to reduce the size of a fine. It would be wrong if they considered such penalties to be simply part of the cost of doing business, Rahman said.

“Companies will have to establish whether the fine issued by the RDC is something routine and in the normal course of business or something that could lead to criminal proceedings,” he said. “If there is a real danger that, following on from this, there will be prosecution it makes sense for those companies to invest in compliance.”

The partial settlement process allows some leeway on negotiating aspects of a case. But it is unlikely that a company will get lenient treatment if it is unable — or unwilling — to improve its processes.

The partly contested avenue also does not prevent the courts from reviewing a case if the subject of the proceedings is unhappy with the RDC decision. However, the statement of facts includes an agreement from the participants that they will not reopen any settled issue unless the court decides to reopen it.

The first case to be brought under the regime, involving Linear Investments Ltd., was completed in April after it was referred to the Upper Tribunal, which upheld a £400,000 fine imposed on the trading broker for failing to directly monitor trades for market abuse. The tribunal ruled that the company was wrong to rely on its brokers for surveillance.

Linear used the partly contested process by agreeing the facts and its liability, but challenged the level of the penalty. After the FCA published its decision on the case in which it upheld the penalty, Linear appealed the dispute to the Upper Tribunal, which agreed with the size of the penalty imposed by the regulator.

The tribunal found the sanction was correct and said Linear's "lack of effective monitoring measures was a serious matter and the FCA's penalty was therefore appropriate."

“Having an independent body like the Tribunal provide its views on the law helps market confidence," Chapman said. "It provides more legal certainty and helps to avoid a resolution process that looks transactional, which is something the FCA itself has expressed concern about.”

The FCA has observed that if the process is going to succeed, the agreed statement of facts — which effectively takes the place of a warning notice — should set out the scope of what is in dispute, with evidence for relevant aggravating or mitigating factors.

But Elam said this could be difficult structurally and logistically.

“You can split the issue out different ways by agreeing a statement of fact in one area and challenging it in others,” he said. “To agree a draft statement of issues covering the mitigating and aggravating points on each side in a document used to test the outstanding issues is quite difficult.”

The partly contested route has potential to improve transparency in the disciplinary process. Chris Stott, a member of Ropes & Gray LLP's litigation and government enforcement practice group in London, said it will focus minds at the FCA as it becomes more widely used and as more companies and individuals start challenging the regulator on sanctions and facts.

“The FCA has to be sure it can justify the stance it has taken before the RDC and the Upper Tribunal,” Stott said. “This will feed into the investigation process, streamline enforcement and feed into the FCA making sure it has a nailed-on case.”

--Editing by Ed Harris and Melissa Lipman.