

## FCA enforcement: a new approach

Following the publication of the Financial Conduct Authority's (FCA) mission in April 2017, the FCA has published a consultation paper that sets out its approach to enforcement (the consultation) ([www.practicallaw.com/w-008-3597](http://www.practicallaw.com/w-008-3597)).

The consultation affirms many of the messages that the FCA has already been articulated about its approach. However, this is the first time that the FCA has set out a consolidated overview of its approach to enforcement.

### The FCA's role in enforcement

The FCA considers that its overriding principle in relation to enforcement is a commitment to achieve fair and just outcomes in response to misconduct that falls within its remit (see box "The FCA's approach to supervision"). The FCA is clear that its rules and requirements must be followed, and those who fail to do so must be held to account.

The levels of financial penalties imposed by the FCA have decreased significantly since 2014, when the FCA imposed penalties totalling just over £1.4 billion. The FCA has previously reassured the industry that this decrease does not mean that it has gone soft. The consultation acknowledges that severe penalties and sanctions alone are not sufficient to reduce and prevent misconduct, and emphasises that serious misconduct will be detected and investigated efficiently by the FCA.

In practice, this means that we are unlikely to have seen the end of the FCA imposing large financial penalties. However, there is likely to be more emphasis on detection and investigations being opened to understand if serious misconduct has occurred. There will also be a continued emphasis on the importance of firms' self-reporting and, where appropriate, seeking proactively to remedy any issues identified or customer losses sustained.

### Identifying potential serious misconduct

The FCA aims to identify potential serious misconduct quickly and at an early stage, in order to reduce the impact on consumers, markets and firms. However, the FCA recognises that this is not easy. Factors that the FCA will consider when determining

### The FCA's approach to supervision

Alongside the Financial Conduct Authority's (FCA) consultation on enforcement, the FCA also launched an equivalent consultation on its approach to supervision ([www.fca.org.uk/publication/corporate/our-approach-supervision.pdf](http://www.fca.org.uk/publication/corporate/our-approach-supervision.pdf)). In this consultation, the FCA identified its supervisory principles:

**Forward-looking.** The FCA aims to pre-empt or address poor conduct so that the risk and any associated harm do not crystallise.

**Strategy and business models.** The FCA assesses firms' strategies and business models to identify emerging risk of harm and to ensure that its supervisory activities are tailored accordingly.

**Culture and governance.** The FCA looks at what drives behaviour within firms and seeks to address the key drivers of that behaviour which are likely to cause harm.

**Individual accountability.** In addition to firm accountability, the FCA seeks to hold individuals to account for their conduct. The introduction of the senior managers and certification regime has assisted the FCA in this regard (see Briefing "Senior managers and certification regime: another year on", [www.practicallaw.com/w-013-8923](http://www.practicallaw.com/w-013-8923)).

**Proportionate and risk-based supervision.** The FCA uses its understanding of markets and firms' business models to target those firms where misconduct would cause the most harm.

**Communication.** The FCA engages directly with consumers and their representatives to understand the issues they face and to target firms that may cause harm to consumers. The FCA also engages with the industry more generally and seeks to be transparent about its work and observations of good and poor practice.

**Co-ordination.** The FCA's supervision division seeks to collaborate internally with other divisions of the FCA. It also co-ordinates with overseas regulators who may supervise firms with a presence in the UK.

**Putting right systemic harm.** When the FCA observes systemic harm, it moves quickly to stop the harm occurring and then works to ensure that the firm modifies the causes of the harm to prevent it from reoccurring. Where serious misconduct is suspected, matters may be referred to the FCA's enforcement division.

if there is potential serious misconduct include:

- The nature and severity of the actual and potential harm.
- The extent to which the suspected misconduct has affected or may affect consumers, markets or firms if the FCA does not take action.
- Whether the suspected misconduct has potentially broader implications.

- Whether the suspected misconduct may have involved a lack of fitness or integrity.
- Whether evidence, including witnesses and documents, is likely to be available.
- The public interest in investigating the matter.

In some cases, it will be relatively straightforward to assess whether there has been potential serious misconduct, but in others it will be more finely balanced. For

example, the FCA has stated that not all breaches of its rules will constitute serious misconduct, especially where the breach is technical or minor. How the FCA will interpret the terms “technical” or “minor” in practice is unpredictable and may vary from case to case.

It is not clear from the consultation how the FCA’s focus on identifying potential serious misconduct fits with the FCA’s enforcement referral criteria, which were refreshed in 2015 (see *News brief “New criteria for FCA enforcement: will they make a difference?”*, [www.practicallaw.com/2-618-3120](http://www.practicallaw.com/2-618-3120)). The FCA has previously stated that the overarching question that it considers when deciding whether to use its investigation powers is whether an enforcement investigation is likely to further the FCA’s aims and statutory objectives, and in doing so it will look at:

- The strength of the evidence and the proportionality and impact of opening an investigation.
- What purpose or goal would be served if the FCA were to take enforcement action.
- Relevant factors to assess whether the purpose of enforcement action is likely to be met.

### Approach to investigations

There has been a noticeable shift in the FCA’s use of enforcement investigations over the past few years. They are used as a diagnostic tool for the FCA to obtain a full understanding of the facts so that it can decide whether to take action and, if so, what kind. Where firms and individuals are suspected of serious misconduct, the FCA has said that it will usually conduct investigations into both firms and individuals in parallel.

This approach has led to the FCA opening more enforcement investigations. As at the end of October 2017, the FCA had 453 open enforcement investigations, compared with the 247 it had 18 months earlier at the end of March 2016. Some investigations are being opened at earlier stages than may have previously been the case, with less investigation work being undertaken before a formal enforcement process is opened.

The FCA has also sought to take a more strategic and efficient approach to its investigations, in order to identify and focus quickly on the crux of the case and decide whether an investigation should continue. This approach should lead to a shorter and more focused process. However, questions have been raised about the speed with which the FCA is handling its increased volume of investigations. In particular, investigations can have a significant personal and professional impact on individuals, so it is essential that they are conducted expeditiously.

### Sanctions and remedies

The FCA has emphasised that any settlement it reaches with a firm or an individual is a regulatory decision and represents an accurate picture of the misconduct that has been investigated.

In the consultation, the FCA indicates that in some cases a financial penalty alone may not be a sufficient sanction. Instead, it emphasises the need for firms to account for any harm that has been caused by their misconduct by, for example, offering redress to customers and undertaking remediation exercises. The rationale is that fines do not benefit those who are affected by a firm’s misconduct, whereas redress directly compensates them. This focus on redress is consistent with the

increased publicity that the FCA has been dedicating to customer redress exercises recently. Some of these have been undertaken in isolation, whereas others have been agreed in the context of an enforcement investigation alongside a financial penalty.

The FCA has made it clear that, if a firm or an individual fails to take steps to address the harm they have caused, this may result in a more severe sanction being imposed. Firms and individuals should not wait until the end of an investigation to undertake redress exercises if required. In practice, this can be challenging for firms and individuals, who may be wary about taking steps that may prejudice their position in an ongoing investigation. However, with the prospect of more severe sanctions being imposed on firms and individuals who fail to do so, many will have to give careful consideration to what can be done in this regard.

### What lies ahead

The FCA is not inviting feedback on its substantive approach to enforcement. Rather, it has limited its request for feedback to whether it has set out its approach to enforcement clearly. The FCA has announced that later in 2018 it will publish a consultation on its policy for the application and calculation of financial penalties, and in 2019, a consultation on other amendments to its enforcement guide.

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*The consultation is at [www.fca.org.uk/publication/corporate/our-approach-enforcement.pdf](http://www.fca.org.uk/publication/corporate/our-approach-enforcement.pdf) and is open for comment until 21 June 2018.*

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