

**Slaughter and May podcast – Investigations and Enforcement Outlook 2021 – Financial Institutions**

<p>Jan Putnis:</p>	<p>Welcome to the second instalment in the Slaughter and May podcast series in which we are going to be discussing the investigations and enforcement outlook for financial services in 2021.</p> <p>In this instalment we will be focussing mainly on the UK market. I am Jan Putnis, a partner in our Financial Regulation group and I am joined by two colleagues.</p>
<p>Ella Williams:</p>	<p>Thanks Jan. I am Ella Williams, senior counsel in the Disputes and Investigations group.</p>
<p>Ewan Brown:</p>	<p>Hello, I'm Ewan Brown, a partner in the Disputes and Investigations group and also Co-Head of our Global Investigations practice.</p>
<p>Jan Putnis:</p>	<p>Thanks Ewan and Ella.</p> <p>So we have seen increased FCA activity in certain areas of enforcement in the last year. It has been quite an interesting one for financial services firms for a whole range of fairly obvious reasons coming out of the COVID crisis.</p> <p>Do you agree with that though Ewan? Do you think that there has indeed been increased activity? That has been my perception, but have you looked at the figures and do you think that is right?</p>
<p>Ewan Brown:</p>	<p>Yes, the work of the FCA, I mean inevitably they had a bit of a downturn in the immediate aftermath of the pandemic last spring, they have certainly I think got back into their stride. They are continuing to open investigations and bring others to a close. There was a bit of a flurry of final notices towards the end of last year and I think we can take quite a lot from them in terms of where they are likely to be heading over the next 12 months or so. I think there are two particular themes I would just like to touch on. First of all market abuse: they have been talking about pursuing market abuse cases for some time. There hadn't in fact been in any final notices since 2017 and then there were a couple last year, one of which was a spoofing case which is an area where the FCA has been quite active. They have got new software to pick up alleged spoofing, and it's an area where we have seen activity obviously in the US of the CFTC taking cases as well, so I think particularly with turbulence in the markets during the pandemic and no doubt in the future we should expect to see continued focus by them on market abuse cases. The other area which the final notices towards the end of last year picked up on, and I think again will be a continuing theme of enforcement activity, is treating customers fairly and in particular treating customers who are in financial difficulties fairly. How are financial services firms dealing with mortgage arrears, loan repayments? There is obviously going to be a balance to be struck between ensuring that banks can collect</p>

	<p>loans that have been made during the pandemic whilst at the same time treating consumers who are, and many of whom will be in some difficulty as a result of the pandemic, fairly, and again I think that is an area which is likely to lead in some cases to enforcement activity.</p>
Jan Putnis:	<p>Ella, very much the focus there on new tools as well as on new areas of enforcement activity. Is that your experience as well over the last year?</p>
Ella Williams:	<p>Yes. The FCA looks for opportunities to use new tools and for new things to add to their tool kit. Last year we saw the well-publicised court action brought by the FCA against various insurers. That was in relation to the terms of insurance policies for business interruption and the case was about whether those policies should pay out in relation to losses caused by business interruption and closure as a result of the pandemic and the government action that we have seen in response to the pandemic. This was clearly an unprecedented situation and the FCA dealt with it in a novel way bringing a test case in the English High Court under a little used procedure called the Financial Markets Test Case Scheme. But the approach worked well for the FCA. They achieved an outcome that was favourable to many policyholders and it brought much clarity to the issues. So, despite the fact that it was an unprecedented situation, they do now have a new proven tool in their armoury and in the right circumstances it's no doubt one they will be willing to use again.</p>
Jan Putnis:	<p>So Ella we have seen some increase in activity in civil enforcements and use of new tools by the FCA in the last year or so. What about criminal investigations though because my perception is that there has been a drop in those? Do you know why that is and first of all, do you think that is the case?</p>
Ella Williams:	<p>You're right there was a drop in criminal investigations undertaken by the FCA in 2020. A Freedom of Information Act request last year showed that they closed half of their open criminal investigations last year but the FCA have also indicated a greater willingness to open criminal investigations, in particular, they have adopted a practice of starting dual track investigations in some cases for a couple of years now and this is where they start the investigation looking at it from both a civil enforcement angle and a criminal angle right from the start before they have looked at any of the facts, rather than taking an alternative approach which would be to start the investigation as a civil enforcement matter and only think about starting a criminal investigation once there is some way into the investigation and have a fuller picture of the facts. So it may be that the relatively high number of criminal investigations that are being dropped is simply a result of the fact that more criminal investigations are being opened in the first place. I know we haven't seen any criminal prosecutions being brought by the FCA under the 2017 Money Laundering Regulations yet but I don't see that as indicative of any lack of appetite to bring criminal prosecutions where that is warranted. The criminal standard that they would have to prove in those prosecutions</p>

	<p>is high and I think that may explain why we haven't seen any so far. We have of course seen the FCA bring other types of criminal prosecutions. We saw the FCA's first criminal prosecution for unlawful destruction of documents culminate last year. Konstantin Vishnyak was tried for the deletion of his WhatsApp app from his phone while he was under investigation and was acquitted in that prosecution and just earlier in February of this year the FCA announced they have commenced criminal prosecutions against two individuals for insider dealing. So it is clear that the FCA don't shy away from using their powers to prosecute where they consider that's the appropriate course of action.</p>
<p>Ewan Brown:</p>	<p>Looking at criminal proceedings being brought by the FCA for AML failures, I think there may be a practical issue here which is simply that trying to pursue dual track investigations does bring its own challenges for them in terms of conducting the criminal aspect of the investigation in such a way that it meets the stricter requirements for evidence gathering in criminal investigations whilst at the same time trying to drive forward the civil aspect, the regulatory aspect, both by enforcement but also maintaining the supervisory dialogue about enhancements to AML controls which the FCA by definition has concerns about. Maintaining that supervisory contact when there is an on-going criminal investigation does bring its challenges. For example, can the FCA ask questions about past failures using its supervisory powers if answers to those questions need to be admitted or may wish to be admitted as evidence in the criminal proceedings?</p>
<p>Jan Putnis:</p>	<p>Ewan we talked about consumer harm earlier and you mentioned vulnerable customers and the mission that the FCA has to prevent or mitigate consumer harm and certainly from my perspective, advising mainly in the non-contentious area of our practice, that is a really important theme and in fact I would even begin to say that the non-contentious is merging with the contentious work. There is a huge area of FCA activity which is not formal enforcement proceedings but does represent various forms of intervention in the business models of regulated firms and there is a wide range of different things that I am certainly seeing. I am seeing a lot more activity imposing requirements on firm's permissions, so the FCA trying to force firms to do or not to do certain things where they think the alternative would be an increased risk of consumer harm. I think an increase, certainly in my perception, in the use of 166 powers and other investigatory powers (information requests, in particular 165 requests) I have seen a big increase in. All of these things investigatory powers falling short of formal enforcement action and at a much lower level a lot more criticism of firms whose business models the FCA does not like. So we see the FCA being much more vociferous about what they don't like about a firm's business model where they think it exposes customers to potential harm. And some themes that come through there across a range of sectors from consumer lending to insurance to certain banking products include the question of whether the customers understand what they are buying, the suitability of the product for customers, what happens to vulnerable customers or</p>

	<p>customers who become vulnerable after they have bought a product not perhaps having been vulnerable when they first entered into the product, the risk of failure of the firms and the FCA has done quite a lot of work on the resilience of the firms and its supervisors in the past year. It sent financial resilience surveys to 23,000 solo regulated firms last year and identified approximately 4,000 of those firms that the FCA considered had “low resilience” or “heightened risk of failure” because of the pandemic. So upper most in the FCA’s mind there is what would happen to customers, would they be disadvantaged or suffer harm as and when those firms fail, if that is what happens to them. Having said all that, the FCA is not what we would call a zero failure regulator. It is not there to guarantee that firms don’t fail, but its general approach seems to be that it wants to ensure that when firms do fail they do so in a sustainable way that minimises harm to customers. That is the mission but I think in carrying out that mission, I will turn to you in a moment and get your views Ewan and Ella, that there is a risk that the FCA ends up lumping firms together and assuming that problems it’s seen in some firms are also present in others because they happen to have a similar business model. So it is very important now for firms to be able to explain their business model to the regulator and also to explain how it does not give rise to consumer harm or if there is a risk of consumer harm what the firm is doing to mitigate that. And to do that based on the firm’s own experience and its own arrangements, to avoid a situation of where there may be an unfavourable comparison between that firm and perhaps another firm where real consumer harm has happened. Any views Ewan or Ella on whether that is consistent with your experience in the last year?</p>
<p>Ewan Brown:</p>	<p>Yes it is. I mean obviously working primarily in enforcement matters we tend to see quite a significant lag between the types of themes that are emerging on the non-contentious and supervisory relationships with the FCA and time elapsing before that works its way through to enforcement action. But there’s no doubt that once the FCA has identified a particular area or product or business type as being high risk, if one firm in that sector or with that model tip into enforcement, the risk others in that area also being tipped into enforcement is reasonably high because we know the thresholds for starting an enforcement action are relatively low. We’ve seen the very large numbers that have been started, many of which have not gone all the way through to a final notice, but in the meantime have caused the firms to being investigated considerable distress and have put them to significant work and effort. In terms of experiences of the last year then obviously the test case, the insurance test case which Ella mentioned earlier, is an example I think of the FCA intervening in a particular sector, perhaps not liking the way that certain insurers were dealing with claimants where the businesses involved were often relatively small, and the FCA saw it as it’s task to expedite payments to those businesses. They didn’t use enforcement tools. They could have done so. Had they done so then some of those issues could have taken much, much longer to resolve. They instead went for a rather inventive process of taking a number of insurers</p>

	<p>through litigation, but achieved their outcome reasonably successfully and reasonably, very quickly in the context of an ongoing pandemic. So again I think that is just another example of non-enforcement activity but which is in any definition contentious.</p>
Jan Putnis	<p>Another feature I've seen of the FCA's supervisory activity in the past year to eighteen months is greater attention to complaints data. This is something the FCA has always looked at but where it's seen trends begin to emerge in the complaints data of firms, particularly firms with similar business models, that in my experience has been the trigger for further supervisory or even enforcement action. And I've seen supervision teams at the FCA look at that data seemingly in more detail than before to see whether there are trends emerging.</p>
Ewan Brown	<p>That's certainly something we see retrospectively in enforcement actions. If there is any investigation relating to consumer products one of the first information requests that the firm could expect to receive in an enforcement action will be for details of the complaints received but also, and perhaps equally importantly, the management information that's been escalated within the organisation on those complaints data because the enforcement team will be looking to see what those trends were showing and what management was doing to pick up on them and take preventative action.</p>
Jan Putnis	<p>To what extent do we think this is a regulator under pressure, after some recent events concerning the criticism of its failure in the LCF case and other situations where it has been criticised for not acting quickly enough to stop consumer harm developing? Are we looking at a regulator which is going to be much more responsive to direct complaints it may receive about the way that particular firms are operating?</p>
Ewan Brown	<p>I think in the current political environment, particularly with unemployment increasing and so forth, that if the media picks up on stories of customer detriment, or the banks or other firms in the financial services sector not treating customers fairly, particularly in areas such as debt arrears, then I think the political pressure on the FCA to act and act swiftly, as it did do in the business interruption case, will be strong. There's a fairly clear direction of travel I think politically that politicians are going to expect the FCA to react and as you said earlier Jan to use their full suite of powers not just their enforcement powers to bring about particular results.</p>
Ella Williams	<p>And we've seen the FCA taking steps to make its position understood in relation to what they expect from firms in this remote virtual world we've been living in. In June last year we heard from Megan Butler, she said that "financial pressures could give rise to harm to customers if firms cut corners on governance or on their systems and controls" in this virtual world. It's no doubt that firms have seen real challenges in ensuring appropriate oversight from a compliance point of view during the last year with our</p>

	remote working practices but the FCA clearly felt that it needed to make clear to firms that they need to meet those challenges.
Ewan Brown	And I think some of the structural changes within the FCA as well have been aimed at that. They are clearly setting themselves up to become a consumer champion. The merger of the two supervision divisions at the end of last year and the creation of the consumer and competition division, headed up by Sheldon Mills who used to be at the CMA, I think again demonstrates that this is an area where the FCA knows that it has to do well.
Jan Putnis	And there is also going to be a powerful new director of markets to sit alongside Sheldon Mills to also look at related market issues. Just thinking about the changes to the way we've all been working in the last year, Ella have you seen a change in the attitude of the FCA in terms of the standards it expects of control functions within regulated firms, really to keep tabs on what staff are doing when working from home, thinking in particular about market conduct, market abuse, and of course control and protection of confidential information? Any developments there you would like to mention?
Ella Williams	No one should be thinking that the FCA's expectations for firms have been in some way fundamentally altered or that the FCA is going to go easy on firms in light of the compliance challenges created by mandatory home working. Julia Hoggett who is the director of oversight at the FCA made that very clear in October last year when she said that the FCA's expectation was that office and home working arrangements should be equivalent. As an example of that, in January this year the FCA issued guidance which said that given how long mandatory home working has been in place for, the FCA expects phone calls and all other relevant communications to be recorded when staff are working outside the office. I think it's clear that the FCA expects firms to step up and meet the compliance challenges that home working creates and continue to take effective steps to prevent misconduct and to protect customers.
Jan Putnis	So what of the international agenda, moving outside the UK, a new presidency in the US - what are we expecting there in terms of intensity of US enforcement action given the effect that often has on our own jurisdiction?
Ewan Brown	Well anecdotally, the sense I'm picking up is that there is expected to be a significant uptake in investigations work in the US. It was clear that enforcement work did not grind to halt under Trump. Quite the reverse, there were a number of significant resolutions during that presidency. There was nevertheless fewer cases around, fewer matters around, than there had been in the previous eight years. I think to an extent that probably also reflects the moment in the economic cycle that we were going through during those four years and that also has changed. So I think everything in

	<p>the US is pointing probably to increased regulatory activity and enforcement activity and as you say Jan, history would suggest that when the DOJ and SEC are active a lot of that spills over to Europe and so I think we may well expect to see enforcement activity over here driven off things that are picked up and initiated in the US.</p>
Jan Putnis	<p>Well that brings us to the end of this podcast. Thank you very much for listening and thank you very much to Ewan and to Ella for joining me in this discussion.</p>