

Welcome changes to the Enforcement Process: more streamlined, efficient and transparent

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The Financial Conduct Authority ("FCA") and the Prudential Regulatory Authority ("PRA") (collectively referred to as "the Regulators") published a joint policy statement ("the Statement") on 1 February 2017.¹ The Statement details the comments received in response to a joint Consultation Paper which set out the Regulators' proposed changes to their enforcement process and policies.² Those proposals effectively reflect and respond to the findings of two reports, both published within the last three years. The first, a report by the Treasury published on 18 December 2014, reviewed the *"fairness, transparency, speed and efficiency of the institutional arrangements and processes for enforcement decision-making"* at the Regulators.³ The second report, written by Andrew Green QC and published in November 2015, constituted Part 5 of the overall report into the failure of HBOS.⁴ Green was tasked to assess *"the reasonableness of the scope of the FSA's enforcement investigations in relation to the failure of HBOS"*.

The Consultation Paper amalgamated the recommendations made in both reports and consulted on the corresponding proposed amendments. Collectively those recommendations concerned issues spanning the entire enforcement process, from referral to contested decision-making. The recent Statement broadly adopts the changes proposed in the Consultation. Below is a summary of some key changes detailed in the Statement, some of which are specific to the FCA. The changes will be formally implemented following the publication of the Statement. Related amendments will be made to the Enforcement Guide and the Decisions Procedure and Penalty Manual ("DEPP") where required.⁵ In due course the PRA intends to publish its own enforcement process guide, including its enforcement referral framework, when it implements other changes suggested in the Treasury's report.

In summary the underlying purpose of the changes is to make the enforcement process more streamlined and transparent. To a large degree these changes should be welcomed by the subjects of enforcement actions and by the Regulators alike.

1. Regular interaction between Supervision and Enforcement during the enforcement action

The Statement recommends quarterly meetings between Supervision and Enforcement, to ensure there is a forum for additional information exchange, and to allow for regular reviews of an

investigation's scope and/or whether other parties should be placed under investigation. In circumstances where both Regulators have an interest in the enforcement action (i.e. for dual-regulated firms), representatives from each Regulator's enforcement and supervisory departments should attend such meetings. One likely consequence of this change in approach, is that the actions of individuals, who are connected with the underlying events of any enforcement action, will be under continual review. Even if initially outside the scope of any investigation, they could subsequently become a subject.

2. More information to be given to subjects of investigations

More detailed information about the grounds for the investigation will be included in the memorandum of appointment including: a succinct summary of the potential breaches; an explanation of the matters that are said to give rise to those breaches; and an explanation of the criteria applied in arriving at the decision to refer the matter to enforcement. The Statement indicates that the FCA has already implemented this approach in practice, but the Enforcement Guide has been formally amended to reflect the change.

As a related point, the FCA and PRA have agreed to adopt a recommendation that scoping meetings should usually take place once investigators are in a position to share their indicative plans on the direction of the investigation and on the timetabling key milestones.

3. Changes to the settlement framework (FCA only)

At least 28 days before settlement Stage 1 formally begins, subjects will be put on notice of its future commencement. This will allow the subject of the investigation to ensure it has the appropriate resources (e.g. the necessary employees) at its disposal during the Stage 1 period.

The FCA will offer a preliminary 'without prejudice' meeting to explain its view of the alleged misconduct (e.g. key facts / interpretations of law, rules). The Statement rejects the suggestion that the FCA should also provide a list of key documents relied on to arrive at its view.

As per the original consultation document, the FCA considers that, in most cases, 28 days is a reasonable period in which subjects can respond to a Stage 1 letter. Whilst there may be exceptional circumstances which merit an extension of that period, the FCA considers that these will generally involve factors outside the subject's control.

Settlement Stages 2 and 3 have been abolished. Stage 2 ran from the end of Stage 1 until the date when the period for making written representations to the Regulatory Decisions Committee ("RDC") had expired. Stage 3 ran from the end of Stage 2 until the Decision Notice was issued. Going forward, for any settlement occurring within the time period previously covered by Stages 2 and 3 the FCA will retain a discretion to apply a discount where appropriate. The justification for this change rests in part on the observation (as made in the Statement) that very few cases have settled in Stage 2 or 3. Given that changes to the Stage 1 process should allow subjects to be better positioned when assessing the merits of settlement, one would imagine that this trend will continue. Although the abolishment of Stages 2 and 3 makes for less certainty in any settlement proposal made during this period, it may also allow the FCA to make more pragmatic and flexible decisions.

4. Partly contested cases (FCA only)

The enforcement process has been streamlined by a formal mechanism through which the issues in any action can be agreed, and hence the scope of the RDC proceedings narrowed. The following three scenarios will be accommodated by this mechanism:

- i. Facts and liability admitted, but the subject of the investigation challenges the sanction the FCA considers appropriate;
- ii. Facts admitted, but the subject challenges whether any breach arises from those facts;
- iii. Partial admission of the issues, i.e. subject challenges some of the issues (or alleged breaches) raised by the FCA.

Where the subject of an investigation only challenges sanction, and accepts liability on the purported facts, the FCA will apply a 30% settlement discount. In respect of the other two scenarios, the FCA declined to promulgate a specific scheme through which settlement discounts could be calculated. Instead the settlement discount is to be left to the RDC's discretion. It remains to be seen whether the subject of an enforcement action will ever be deemed to warrant a reduction in penalty in circumstances where they challenge that their conduct amounted to a breach, except perhaps where it is accepted that the relevant published rules or guidance are ambiguous or inconsistent.

5. Expedited Reference to the Tribunal (FCA only)

The FCA will add a new section to DEPP setting out the "expedited reference procedure". This enables the subject of any enforcement action to challenge the proposed action before the Upper Tribunal without engaging with the FCA's internal decision-making process. In essence, the process allows the subject to lodge the Tribunal reference once the FCA has issued a Warning Notice.

This procedure is only available where the:

- the proposed action requires the FCA to issue a warning notice;
- the FCA considers that it has a sufficient understanding of the nature and gravity of the breach to make a reasonable assessment of the appropriate penalty or other outcome;
- and**
- the FCA has communicated that assessment to the person concerned.

Conclusion

These changes should have their intended effect. They offer formal mechanisms through which the issues of any enforcement action can be properly narrowed. It is perhaps understandable that 'partly contested cases', in which some conduct or issues are admitted, are immune from formulaic guidance on penalty discounts. A discretionary and flexible approach would seem more sensible and workable, even at the expense of certainty. It remains to be seen whether a formula, for how the ultimate penalty will be calculated, can be agreed upon at the time when the issues are narrowed. However, the FCA would no doubt consider the extent to which its effort and resource would be reduced by certain issues being admitted. Greater transparency at the outset of the investigation and in advance of Stage 1 settlement will enable subjects to better understand the strength of the

case they face. Furthermore, the related obligations borne by the Regulators will focus the minds of their respective enforcement divisions. It will be interesting to see how frequently, and in what circumstances, the subjects of investigations opt to proceed direct to the Tribunal and thereby avoid the RDC process.

¹ The Statement is available at <https://www.fca.org.uk/publication/policy/ps17-01.pdf>.

² The Consultation paper is available at <https://www.fca.org.uk/publication/consultation/cp16-10.pdf>.

³ The Treasury's report ('Review of enforcement decision-making at the financial services regulators: call for evidence') is available at <https://www.gov.uk/government/consultations/review-of-enforcement-decision-making-at-the-financial-services-regulators-call-for-evidence/review-of-enforcement-decision-making-at-the-financial-services-regulators-call-for-evidence>.

⁴ Andrew Green QC's report is available at <http://www.bankofengland.co.uk/prd/Documents/publications/reports/agreenreport.pdf>.

⁵ The specific amendments to the text of Enforcement Guide and DEPP are contained in an annex to the Statement. For the most part they came into effect on 31 January 2017, but some formally apply as of 1 March 2017.