FINANCE LITIGATION GROUP PODCAST SERIES 2021

Trends in FCA enforcement 2020/21

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In this podcast, we look back at some of the themes emerging from FCA enforcement activity in the past year. We will also consider the FCA's approach to the adoption of new operational models which many financial services firms have embraced following the Coronavirus restrictions placed on businesses in March 2020 and how it expects firms to address some of the risks which flow from those new ways of working.

The FCA's focus on financial crime continues with a number of cases relating to AML failings. On the regulatory side, Goldman Sachs was issued with a final notice in October 2020 and fined a total of £96.6 million in relation to risk management failures connected to Malaysian strategic development agency 1Malaysia Development Berhad (1MDB) and its role in three fund raising transactions for 1MDB. This was part of a US$2.9 billion globally coordinated resolution.

The investigation found that Goldman Sachs had failed to:

- assess with due skill, care and diligence the risk factors that arose in each of the 1MDB bond transactions on a sufficiently holistic basis;
- to assess and manage the risk of the involvement in the 1MDB bond transactions of a third party that GSI had serious concerns about;
- to exercise due skill, care and diligence when managing allegations of bribery and misconduct in connection with 1MDB and the third 1MDB bond transaction; and
- had failed to record in sufficient detail the assessment and management of risk associated with the 1MDB bond transactions.

March of this year saw the FCA bring its first criminal prosecution under the Money Laundering Regulations 2007 and the first brought by any prosecutor under the Money Laundering Regulations against a bank. In a case which concerned cash deposits by a business customer, NatWest pleaded guilty in October of this year to three counts of breaches of Regulations 8(1) and 8(3) and Regulation 14(1), which required firms to establish and maintain adequate systems and controls to prevent money laundering. Regulation 8(1) and (3) requires firms to conduct ongoing monitoring of a business relationship on a risk sensitive basis. Regulation 14(1) requires firms to apply - on a risk sensitive basis - enhanced customer due diligence measures and to undertake enhanced monitoring in any situation which by its nature can present a higher risk of money laundering or terrorist financing. The charges relate to NatWest's failure to monitor the relationship with a client which deposited £365m in its accounts over five years in a series of transactions, of which around £265m was deposited in cash. The FCA's approach in this case is widely regarded as signalling a new and more aggressive approach by the FCA to AML systems and controls failings.

On the retail side, we have seen proposals for the introduction of the new consumer duty, together with a focus on "treating customers fairly", or TCF, and, in particular, fair treatment of vulnerable customers. This is quite clearly going to be increasingly significant in relation to customers who are financially distressed as a consequence of lockdown restrictions. In this regard, it will be interesting to see what approach is taken by the regulator in respect of SME lending which currently stands outside the regulatory perimeter – particularly, as the first repayments under the Bounce Back and Coronavirus Business Interruption Loan Schemes begin to fall due.

Most SMEs wishing to report detrimental treatment by financial services firms will now come within the expanded jurisdiction of the Financial Ombudsman Service and larger SMEs will be able to engage with the new Business Banking Resolution Service which launched in February of this year.

Perhaps unsurprisingly, the FCA's Annual Report for the year ended 31 March 2021 reflects that enforcement activity fell, with fewer new cases being commenced, and fewer financial penalties being imposed.

This is consistent with what we have been seeing over this period. Enforcement cases seem to have been progressing less quickly, with home working having an inevitable impact on the regulators ability to conduct their investigations in the usual way, with scoping meetings and interviews being conducted remotely.

Looking to what new risks may have emerged over the past year, perhaps the most profound operational shift that has occurred in financial services businesses in the recent past has been the move to home working in March 2020, which has since become a much more permanent feature of the way in which many businesses now operate.

The attendant risks of having financial services business conducted from disparate premises which are not under the direct physical control of the regulated firm are not straightforward to address.

The FCA has emphasised the market integrity risks of home working and we anticipate that we may begin to see cases coming through in this area.

Businesses have had to grapple with the information security risks as a consequence of a lack of physical oversight of personnel and from the fact that information which might ordinarily be kept securely on business premises, may have been stored at the residential addresses of employees.

Not only has security of information become more complex to safeguard, but there has also been an increase in the amount of inside information generated by rapid and unexpected changes in the financial condition of companies due to the profound economic changes and legal restrictions over the past 18 months.

The FCA has published a list of points to consider when establishing a remote or hybrid working environment, and has made clear that firms must ensure that:

- An appropriate culture is maintained in a remote or hybrid working environment.
- Control functions such as risk, compliance and internal audit are able to carry out their functions unaffected, such as when listening to client calls or reviewing files.
- That appropriate record keeping procedures are in place.
- The firm can meet and continue to meet any specific regulatory requirements, such as call recordings, order and trade surveillance, and consumers being able to access services.
- Where any staff will be working from abroad the firm has considered the operational and legal risks (and, indeed compliance with the threshold requirements).
- Firms should also be able to cascade policies and procedures to reduce any potential for financial crime arising from its working arrangements.

While robust technological solutions can provide an answer to some of these issues, the culture of a firm is always going to be much more difficult to maintain in a remote or hybrid setting and this may provide the biggest challenge for many firms. The FCA has focussed upon culture in recent years and considers it to be an essential pillar of a firm's protections against financial crime so it is important to consider what the firm is doing to preserve the right culture in the new working environment.

On a practical level, another very important factor to consider is the FCA's requirement under SUP 2.3 to be provided with ready access, with or without notice, to business information for regulatory purposes, whether from the supervisory or enforcement side. Firms will need to consider how they can ensure that they are able to meet those requirements where information may be stored off-premises as a consequence of home or hybrid working arrangements. The SUP guidance makes clear that the FCA expects firms to take reasonable steps to ensure that its employees also comply with those requirements.

Employees who are working from home should be made aware of this and also of the FCA's powers under certain circumstances to enter premises, with - or in some cases - without a judicial warrant, some of which may extend to residential premises, particularly where they are being used for the conduct of regulated business.

Looking ahead to the coming year, in its business plan the FCA has indicated that it will be taking a more assertive approach and has budgeted for an investment of over £120 million over the next three years to further automate its data collection processes, and to use improved technology to enhance the analysis of that data in order to strengthen its ability to detect and investigate market misconduct. The focus here will be on prevention and early intervention. This expansion of the FCA's detection toolkit and stated commitment to seek out market abuse, is an indication that we can expect to see more investigations commenced in this area going forward.