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Litigation & Arbitration Group Client Alert: FCA and PRA announce key changes to their enforcement processes

On 1 February 2017, the Financial Conduct Authority (“**FCA**”) and Prudential Regulation Authority (“**PRA**”) published important changes to their enforcement decision-making processes¹. The changes cover the full life cycle of an investigation and are aimed at strengthening transparency and the effectiveness of these processes. They are, therefore, of importance to both firms and individuals who are under investigation by the FCA and/or PRA.

BACKGROUND

The changes are intended to address many of the recommendations made by HM Treasury in its “*Review of enforcement decision-making at the financial services regulators*” (which was published in December 2014) and in Andrew Green QC’s “*Report into the FCA’s enforcement actions following the failure of HBOS*” (published in November 2015).

We summarise below the key changes concerning transparency and settlement which the FCA is making.

TRANSPARENCY DURING THE INVESTIGATION

It is not uncommon for the Memorandum of Appointment of Investigators (“**MoA**”) which is produced by the FCA at the outset of an investigation, to be couched in general terms so that the subject of the investigation has no clear understanding of the FCA’s concerns. In the future, the FCA will set out a summary of the potential breaches, an explanation of the matters which are said to give rise to those breaches and an explanation of the criteria which have been applied in coming to the decision to investigate.

¹ “Implementation of the Enforcement Review and Green Report” Policy Statement FCA PS17/1 PRA PS2/17

Similarly, there has been a tendency for ‘scoping’ meetings, which are held at the start of an investigation, to be uninformative and to provide little more information than is set out in the MoA. The FCA now proposes that scoping meetings should usually take place once the investigators are able to share more information about the direction and timetable of the investigation. This is likely to mean that these meetings take place at a later stage than has been the case, although the FCA will retain some flexibility about the timing.

In order to keep those under investigation better informed about the progress of the investigation, the FCA will now give periodic updates (usually by telephone or letter) on at least a quarterly basis. These updates will focus mainly on the steps which the FCA has taken in the investigation but will also address next steps. It will be interesting to see whether, in practice, the FCA uses these updates as a means of sharing its emerging thinking about the issues under investigation.

SETTLEMENT

Under the current FCA settlement process, a penalty which is imposed may be reduced depending on the stage at which a settlement is reached.

Stage 1: a 30% reduction applies if settlement is reached at any stage between the start of the investigation and the point at which the FCA has sufficient understanding of the nature and gravity of the breach and has allowed the subject of investigation a reasonable opportunity (usually 28 days) to reach an agreement.

Stage 2: a 20% reduction applies if settlement is reached after the end of stage 1 and on or before the last day for making written representations in response to a Warning Notice.

Stage 3: a 10% reduction applies if settlement is reached after the end of stage 2 and before a Decision Notice is issued.

To enable the subject of an investigation to prepare, the FCA will aim to give 28 days’ notice of the beginning of stage 1 and “*where appropriate, will offer a preliminary without prejudice meeting to explain the FCA’s view of the misconduct (including the key factual and legal bases for its view)*”. In order to make stage 1 more effective, the FCA will also provide its proposed findings and key evidence at the start of stage 1. However, the FCA remains of the view that the 28-day period, which is usually given for stage 1, is sufficient and that this will only be extended in exceptional circumstances.

Perhaps the most significant change is the introduction of “*focused resolution agreements*”. This change, which will take effect from 1 March 2017, will enable a settlement

to be reached covering some aspects of a case whilst others remain in dispute. A person under investigation will be able to agree certain elements of a case (for example, the level of the penalty, some or all of the facts, whether any breaches have been committed or a combination of these) but still contest other elements of the case. Those elements which remain in dispute will then be determined by the Regulatory Decisions Committee (“**RDC**”) or the Upper Tribunal. The amount of the discount which will be available will depend on how much of the case has been agreed. If the facts and the breaches are agreed and only the penalty remains in dispute, the amount of the discount will be 30%. If the facts are agreed but both liability and penalty are contested, the amount of the discount will be between 15 and 30%. In other cases, for example where the facts remain in dispute, the discount will be between 0% and 30%. This is a helpful development and will go some way to addressing the very considerable pressure, which subjects of investigations have felt, to make concessions in order to settle at the earliest possible stage to obtain an early settlement discount.

To date, settlement negotiations with the FCA have been a common source of frustration. The absence of any senior individual from the FCA has enabled the FCA representatives to adopt an inflexible approach and be reluctant to engage in constructive discussions. The FCA proposes to clarify the involvement of senior managers in the negotiations so that “*where appropriate, and having regard to the size complexity and seriousness of the case*”, the Head of Department will attend a without prejudice meeting. The wording clearly gives the FCA considerable flexibility, so how helpful this proves to be in practice remains to be seen.

Another significant change is the abolition (with effect from 1 March 2017) of the stage 2 and stage 3 discounts. The FCA has concluded that the introduction of focused resolution agreements enables a subject under investigation potentially to obtain a discount of up to 30% on the penalty without settling all matters and that the discounts which were previously available at stages 2 and 3 did not optimize settlement prospects. As a result, in the future, if settlement is not reached at stage 1 and a focused resolution agreement has not been agreed, there will be no discount for early settlement.

Finally, the FCA has said that, despite concerns from the industry, it will adopt its proposal that it will be usual for the same RDC panel which decides whether to issue a Warning Notice to consider, also, whether to issue a Decision Notice (although this is not an absolute rule). One of the reasons for adopting this approach is that it provides flexibility and scope for arranging representation hearings more swiftly.

CONCLUSION

Overall, these changes to the FCA’s enforcement processes, which will bring greater transparency, will be welcomed by firms and individuals under investigation. Howev-

er, it is doubtful that the changes will result in any significant reduction in the length of time which the investigation process takes. This has been a longstanding cause for concern.

Further changes to the enforcement process may be made when the results of the FCA's ongoing review of its financial penalties policy are published.

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