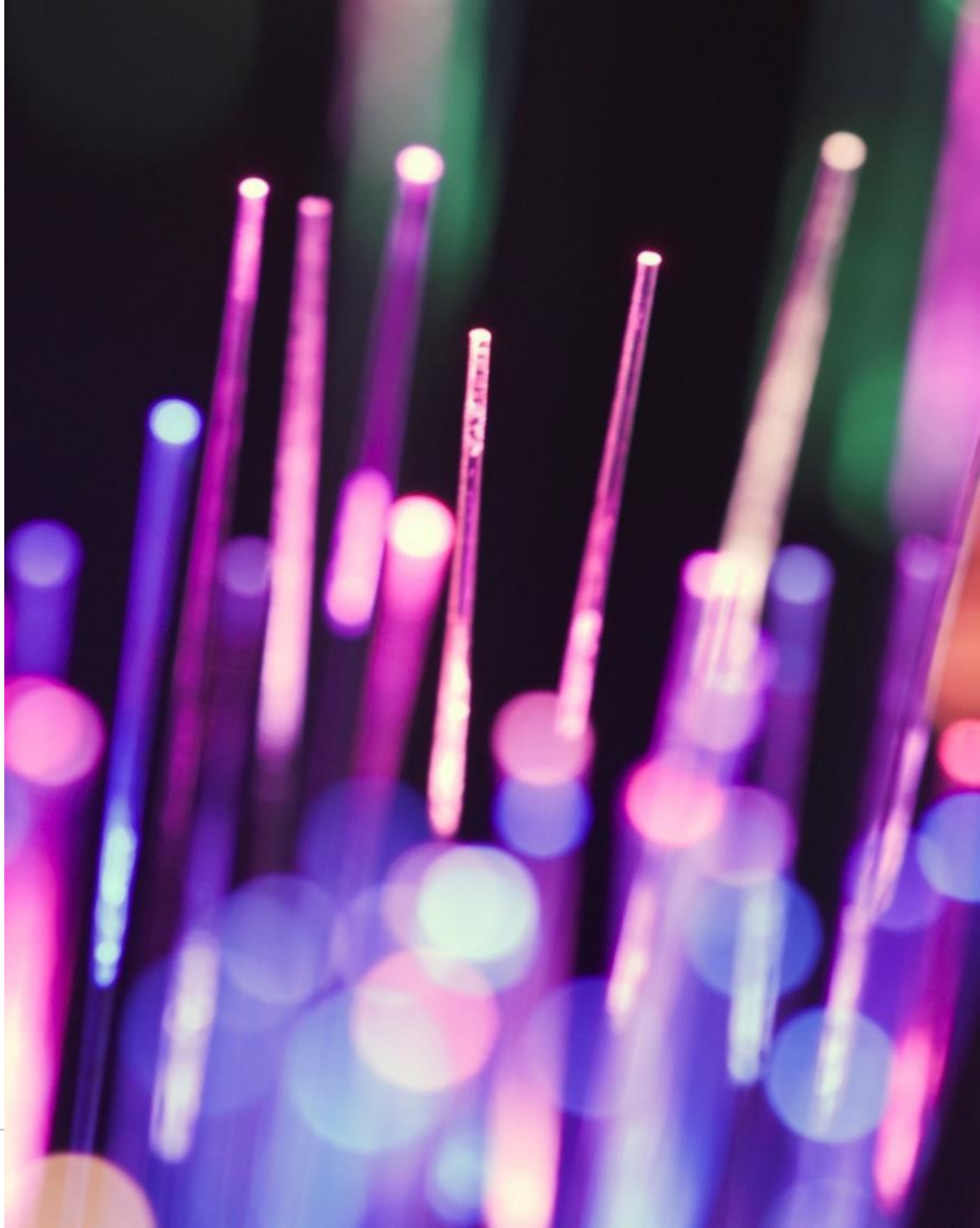
Linklaters

Financial services interventions and enforcement trends 2024



Financial services interventions and enforcement trends

2024

2023 is perhaps best described as a ‘steady but unremarkable’ year for regulatory enforcement against financial services firms. Whilst FCA-regulated firms wait for a better sense of the overall future direction of the FCA’s enforcement efforts, the FCA concluded several cases during 2023, with a particular focus on AML and retail harms. The PRA continued to progress a comparatively small but targeted caseload, concluding two cases against firms and the first case against a Senior Manager for breach of the Senior Manager Conduct Rules. The PRA has diverged further from the FCA in relation to its enforcement practice and penalty policy, demonstrating both its growing confidence and its different strategic priorities.

2024 is likely to herald a ‘resetting’ of the FCA’s enforcement strategy, with Therese Chambers and Steve Smart signalling to the market how they plan to take the FCA’s Enforcement and Market Oversight division under their new leadership. With some stinging criticisms from the Upper Tribunal last year regarding delays and other failings in its enforcement processes as well as challenges to the more aggressive use of certain of its statutory powers, the FCA is clearly thinking again about how its enforcement powers will support the FCA’s broader policy objectives most effectively.

This publication contains our view of the key themes emerging from last year’s enforcement activity and our views on the areas likely to dominate FCA and PRA focus from an enforcement and assertive supervision perspective over the coming 12-18 months.

Retail

Redress; advice and mis-selling; vulnerability; Consumer Duty interventions

Wholesale

Financial and prudential risk management; continuous disclosure; insider dealing; market abuse

Financial crime

AML controls; sanctions controls; cum-ex; prosecutions

Tech and operational resilience

Cyber-resilience; outsourcing; concentration risk and critical third parties

Individual accountability

SMCR enforcement; FCA setbacks in the Upper Tribunal; non-financial misconduct

Policy, practice and procedure

An FCA reset under new leadership; a data-led approach; more interventions; perimeter policing; PRA policy changes

Retail

Whilst the FCA's new Consumer Duty arguably represents the most significant regulatory change in this area, it will be some time before it begins to be used as the basis for enforcement. In the near term it will be used principally as a tool for more intrusive/assertive, data-led, supervision.

In the meantime, the FCA's enforcement work has continued to focus on the remediation of historic failures involving poor advice and vulnerable customers.

Effective redress was a prominent feature of 2023, with two areas of historic harm dominating the debate - British Steel Pensions Scheme advice failings and the fallout from the collapse of the LF Woodford Equity Income Fund.

This is the first time in several years that we have not seen enforcement action concluded against a major high-street retail bank.

Redress and co-operation

The FCA began the year – in what was to become something of a theme in 2023 – defending one of its redress schemes, in this case the scheme covering British Steel Pension Scheme beneficiaries. It also censured but chose not to fine Amigo Loans Limited £72.9m, on the basis that a fine would have jeopardised the firm's ability to meet its commitments to deliver redress pursuant to a High Court sanctioned scheme of arrangement (which had already been amended following FCA opposition and an initial High Court rejection).

It is becoming ever more important to the FCA to secure effective redress for customers – indeed it now rivals deterrence in the FCA's list of priorities. This made the Upper Tribunal's decision in BlueCrest Capital Management that much more frustrating for the FCA. The Upper Tribunal held that the FCA does not have a freestanding power to impose redress even if one of its operational objectives (e.g. consumer protection) is met. Equally, it could not require redress on the basis of a breach of the Principles for Business alone (in this case, Principle 8) – an underlying rule breach is required. The FCA is appealing the decision.

Meanwhile, in June, FCA Co-Director of Enforcement Therese Chambers used her inaugural speech to heap praise on Quilter, the new owners of Lighthouse Advisory Services, for "*taking responsibility*" for historic unsuitable advice given by the firm to former members of the British Steel Pension Scheme and for offering proactive redress. Such was the value of Quilter's co-operation – described as "*exemplary*" – that the FCA chose not to impose a financial penalty on Lighthouse. The FCA highlighted Quilter's voluntary production of external legal counsel's investigation report, its retention of a key employee to assist with providing information to the FCA and its proactive production of information.

Whilst a baseline of co-operation is expected by all firms subject to enforcement, the FCA has long suggested that "*exemplary*" efforts might justify a significant reduction in any eventual penalty. Ms Chambers emphasised this in her speech, encouraging firms to "*do the right thing*". The difficulty for firms here remains that there is no way of understanding in advance what behaviour will precipitate a reduction – similar co-operation in other cases has not led to the same outcome and the prospect of substantial co-operation credit remains substantially at the ex post facto discretion of the FCA. The PRA's new Early Account Scheme offers the prospect of greater clarity, although there are separate concerns (which the PRA doesn't share) that the tariff ranges indicated in the PRA's consultation paper will lead overall to higher penalties than have been imposed currently, even after the application of an EAS discount.

Retail

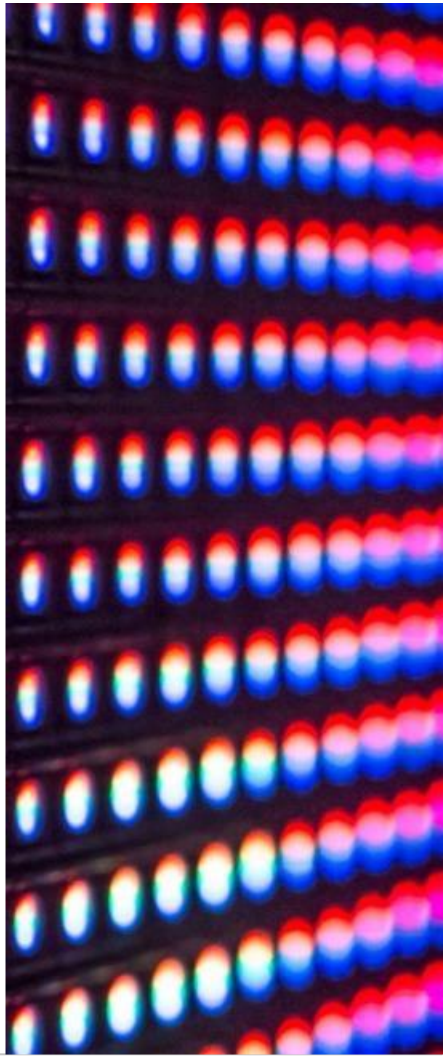
Elsewhere we saw a slew of concluded enforcement cases against providers of defined benefit pensions scheme advice related to the British Steel (and other) pensions schemes. Around 30 investigations have been undertaken, with two types of misconduct found – a lack of 'due skill, care and diligence' (breaching Principle 2) and in certain cases a concern that firms or advisers conducted their business with a lack of integrity (breaching Principle 1). The FCA published final or decision notices against 13 individual advisers in 2023, with the majority ordered to pay a penalty and all receiving some form of prohibition. Three individuals have referred their decisions to the Upper Tribunal.

The FCA continued to seek redress for investors in the LF Woodford Equity Income Fund (**WEIF**) from Link Fund Solutions (**LFS**), WEIF's authorised corporate director (**ACD**), in respect of losses from liquidity management issues around the time redemptions were suspended. An earlier attempt, which followed interest from Dye & Durham (**D&D**) in acquiring LFS, fell through when the FCA required D&D to meet any redress shortfall as a condition of the change in control.

In April 2023, the FCA announced a conditional settlement of its investigation of LFS into the circumstances leading to the suspension of the WEIF and LFS's role as ACD. As part of the deal, LFS proposed to enter into a scheme of arrangement pursuant to which it would pay all of its assets into the WEIF and its ultimate parent Link Group would also make a contribution of up to £60m (funds the FCA maintained would not otherwise be available). Despite criticism and suggestions that investors might recover more via group litigation – described by the FCA as "*self-interested*" – or via the FSCS in the event LFS defaulted in relation to orders to pay higher levels of redress, the FCA continued to back the proposal. Investors voted to approve in December 2023, and the scheme awaits Court sanction in early 2024.

The frustration that LFS was unable to give redress without resorting to a scheme was evident, and it is no surprise that the FCA has and will likely continue to focus on the financial resilience of firms, including requiring firms to model their ability to fund redress in given scenarios to support robust capital planning as part of the ICARA process.

Given the ongoing cost of living crisis, the FCA has continued to focus on vulnerable customers. Of note is its use of powers under the Consumer Rights Act 2015 to secure undertakings from PayPal Europe and QVC UK to voluntarily make their continuous payment authority (**CPA**) terms easier to understand. The FCA was concerned that the terms did not clearly state either what a CPA was or clearly explain the ways in which the CPA could be modified or cancelled by consumers. In addition, PayPal made its explanation of the consequences for consumers for cancelling a purchase within the 14-day cooling-off period clearer and fairer. The FCA data shows that 27% of UK adults used BNPL at least once in the six months prior to January 2023, an increase of 17% from the preceding twelve months in May 2022, underlining the FCA's work to bring this area within the regulatory perimeter.



Retail

Consumer Duty

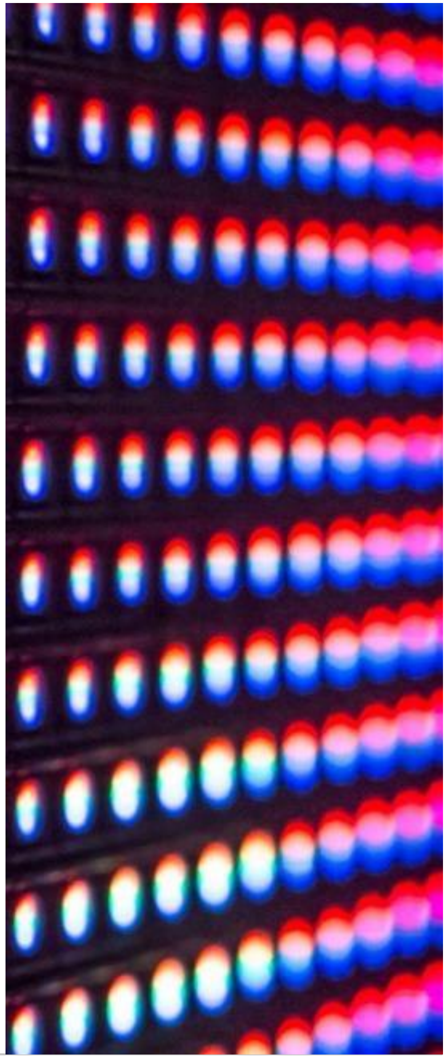
Billed as the most far-reaching, cross-cutting regulatory change in retail financial services since the Treating Customers Fairly initiative 20 years ago, the FCA Consumer Duty (**Duty**) came into force for new and existing products on 31 July 2023.

The FCA was quick to utilise the new requirements as the basis for tackling concerns about the speed at which retail banks were (or were not) passing on the benefit of interest rate rises to customers with savings accounts. Similar criticisms were levelled at investment platforms holding cash balances in a letter sent by the FCA in September 2023, with a second, stronger letter on the point sent to investment platform CEOs in December 2023 giving firms until the end of January 2024 to revise their assessments of value and respond to the FCA's concerns, with one further month to implement relevant changes. It is likely that sector-focused 'Dear CEO' or portfolio supervision letters outlining good practice and raising concerns, followed by more concrete calls to action if progress is not forthcoming, will be a commonly utilised technique to address perceived non-compliance with the Duty.

In a recent appearance before the Treasury Select Committee, FCA CEO Nikhil Rathi indicated that the FCA was not planning on enforcing every technical breach of the Duty, but would be focusing on the most egregious harms to "*allow the Duty to settle*". He confirmed that enforcement would come "*some way down the track*".

Change is already apparent. The FCA has recently completed a multi-bank review into early work by retail banks on implementing the Duty. Value is emerging as a key early area of focus across sectors (particularly in the asset and wealth management sector) and there have been some high-profile examples of firms changing their business model and approach to pricing. A number of practices are likely to face greater scrutiny – for example, charging for products that customers are not accessing, possible over-trading to generate transaction fees, promoting expensive products that do not meet customer needs, poor disclosures around charging structures/fees and exit fees. In his December 2023 Treasury Select Committee appearance, Nikhil Rathi also cited clearer communications, increased switching from low value products and reviews of product suitability as examples of other early benefits of implementation.

The FCA remains concerned that firms are not thinking sufficiently broadly and deeply about the treatment of vulnerable customers. The FCA expects firms to assess customers' circumstances dynamically, noting that customers may move into and out of vulnerability, with 50% of the population likely to be classed as 'vulnerable' at any one time. The FCA expressed disappointment that almost 50% of portfolio managers were recently unable to identify any vulnerable customers within their client base – wealth does not insulate customers from vulnerability as the FCA defines it. Similarly, in its retail multi-bank review, few firms were able to identify vulnerable customers within their business current account offerings. The Duty will apply to SME customers where they are classified as 'retail' for the purposes of the relevant sourcebook. FCA expects firms to be able to identify in-scope business customers in vulnerable circumstances to the same standard as they would personal customers.

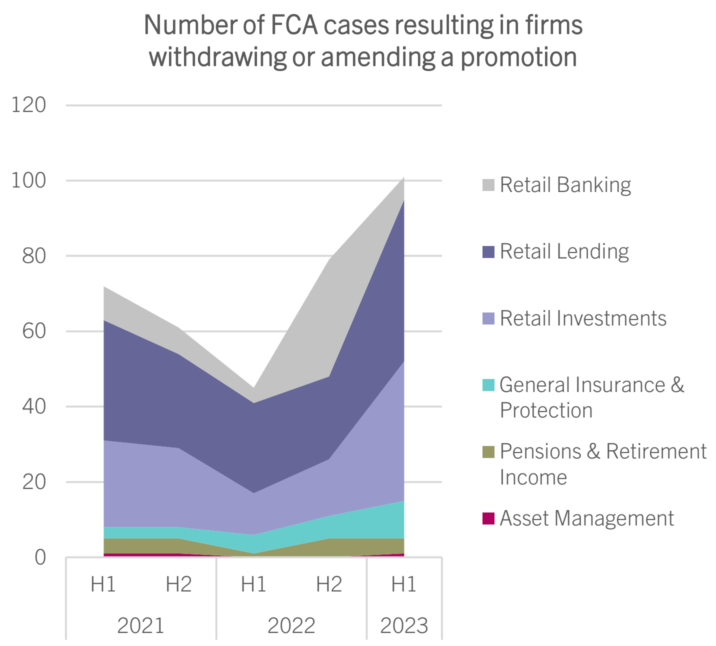


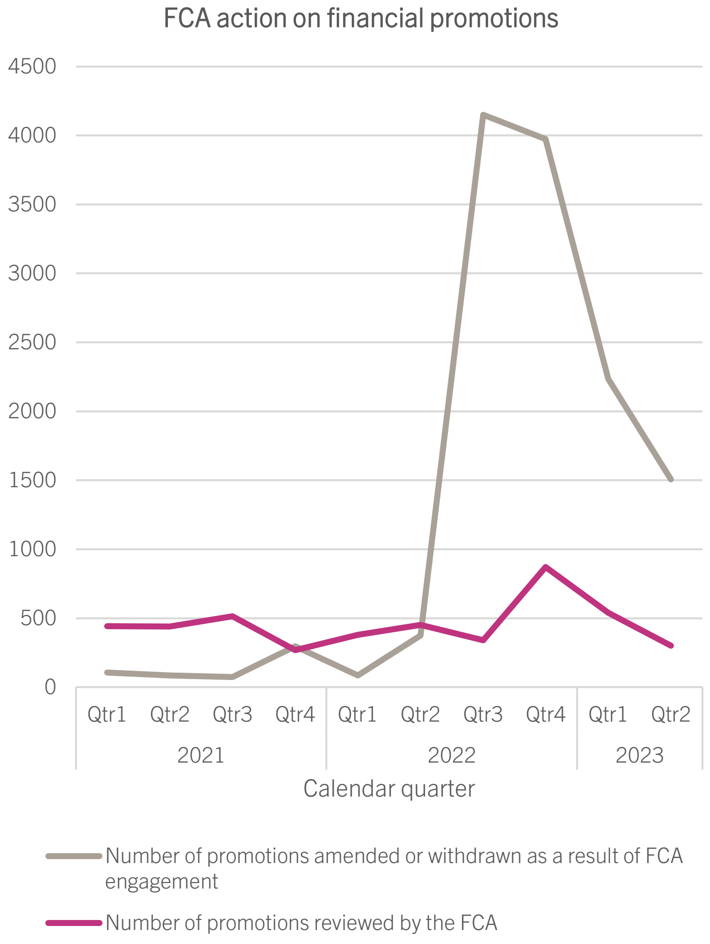
Retail

Other areas of concern (and therefore likely supervisory and/or enforcement activity in due course) include the processes by which firms opt clients up to professional status (taking them out of the protections offered by the Duty) and customer communications. The latter is an area where we are seeing a raft of additional policy work, including the proposed review of the PRIIPs regime, proposals to tighten up the processes for the approval of financial promotions through the introduction of a new gateway regime (with cryptoassets given particular attention) and the publication of the FCA's Sustainability Disclosure Requirements, including a new anti-greenwashing principle, in November.

High risk investments and fraud

The FCA has intensified its efforts to raise awareness of the dangers of higher risk investments and to increase vigilance against fraud, but faces considerable challenges in keeping pace with a rapidly evolving landscape. Much of the work has been on tougher policing of financial promotions. The FCA's February 2023 annual financial promotions report revealed that FCA intervention led to 8,582 promotions being amended or withdrawn in 2022, which was a 14-fold increase on 2021. The FCA has also been working with the Advertising Standards Authority to help educate consumers and 'finfluencers' about the risks involved in promoting financial products, and issued new draft guidance in relation to the issuance of financial promotions on social media. In October 2023, the FCA also issued a public censure to London Capital & Finance plc for significant failings in relation to financial promotions related to so-called 'mini-bonds'. SFO and FRC investigations are ongoing.



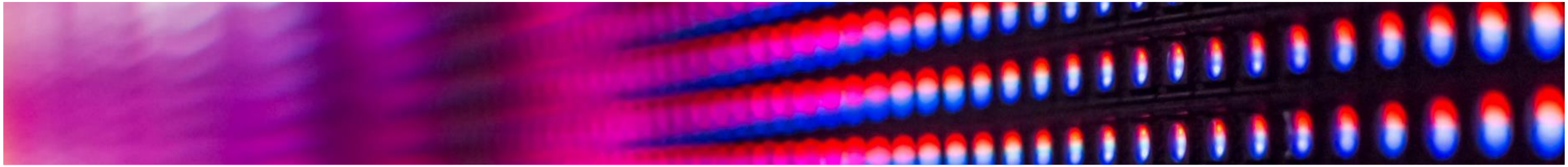


Retail

Since October 2023, firms wishing to promote cryptoassets in the UK to retail consumers must be authorised or registered by the FCA, or have their marketing approved by an authorised firm. On 10 October 2023, the FCA announced that it had used its s.55L FSMA to impose restrictions on Rebuildingsociety.com Limited. Whilst the firm was duly authorised, the FCA restricted it from approving cryptoasset related financial promotions. The restrictions came just days after Binance – one of the world's largest cryptoasset exchanges – announced a partnership with Rebuildingsociety.com to facilitate Binance promoting its offerings in the UK in compliance with the new crypto promotions rules.

Firms were handed a welcome decision by the Supreme Court in July in *Philipp v Barclays Bank UK plc* in the context of a debate about where the burden of authorised push payment (APP) fraud should fall. The decision provides welcome clarity for banks and other firms in relation to the relationship of the 'Quincecare duty' with the payment obligations of banks and other payments firms, confirming that once a clear and unequivocal instruction to pay has been given by a customer, banks are obliged to fulfil it even if this has been secured by fraud.

The consequences of this decision are perhaps more limited than they might otherwise have been given the Contingent Reimbursement Model Code for APP scams (which post-dates the facts giving rise to *Philipp*) and the statutory liability arrangements introduced by s.72 of the Financial Services and Markets Act 2023. Further, the Duty arguably imposes obligations which go beyond those set out arising in the Quincecare context, including considering the impact of behavioural biases on customer decision-making and in some circumstances a positive duty to intervene to act to prevent foreseeable harm.



Wholesale

The most notable wholesale enforcement outcome in 2023 was the PRA's £87m fine of Credit Suisse for historic failings relating to the collapse of Archegos.

We also saw the PRA take its first action against a firm and against its former CEO for breaches of large exposure limits.

The FCA, meanwhile, focused its wholesale enforcement activity on market abuse and financial crime related matters, a trend which we expect will continue into 2024.

We will see ongoing focus on risk management controls and increasing attention to prudential requirements including to facilitate orderly resolutions.

The PRA continues to pursue a small but impactful enforcement docket focused on prudential weaknesses. In April, it issued a public censure to Wyelands Bank Plc for various breaches relating to large exposure limits, capital reporting, governance and risk controls, contraventions of PRA Own Initiative Requirements (**OIREQs**) and poor record-keeping (including non-retention of WhatsApp messages, an issue which has led to US regulators imposing significant fines). The PRA would have imposed a fine of £8.5m were it not for Wyelands being in wind-down and demonstrating that a fine would cause it serious financial hardship. In January 2024, the PRA imposed a fine of £118,808 on the former CEO of Wyelands for breaches of the Individual and Senior Manager Conduct Rules arising from his role in relation to these matters. The PRA also accepted an undertaking from the individual not to work in UK financial services.

The PRA observed that smaller deposit-takers entering into complex transactions must ensure their controls and risk management enable them to analyse and manage these transactions in the context of the firm's overall risk profile. The PRA also highlighted the inherent conduct risk where a firm's business plan is highly dependent on introduced transactions, including connected party and related party risks in relation to transactions involving a firm's wider group.

In July 2023, the PRA imposed its highest fine to date, a penalty of £87m, on Credit Suisse International and Credit Suisse Securities (Europe) Ltd for risk management and governance issues relating to its management of the risks associated with its dealings with Archegos Capital Management. The key messages from the notice centred on the need for clear and transparent ownership and responsibility for risk at a local level; the need for prompt and effective risk mitigation; the need for effective first line governance and ownership of risk; and the need for an appropriately empowered and effective second line risk oversight function.

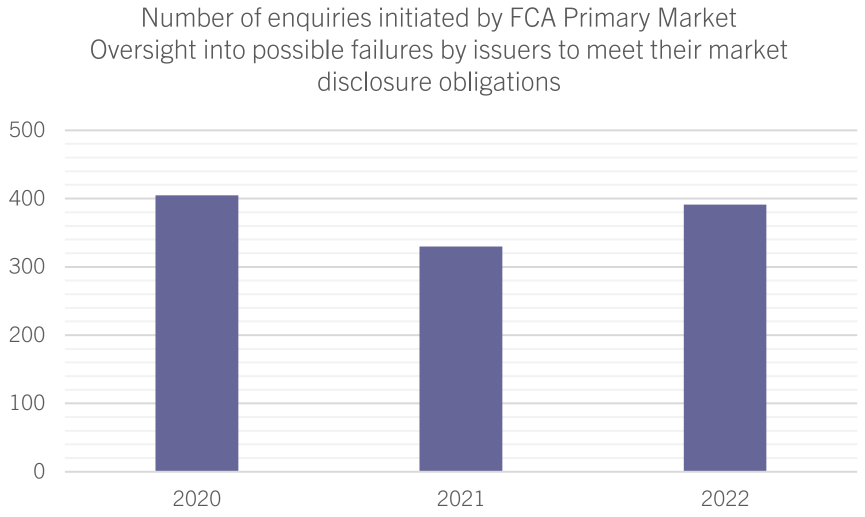
The focus on firms' risk management and governance arrangements was also evident in the review by the Bank of England (**BoE**) of the events surrounding the suspension of the nickel market by the London Metal Exchange (**LME**) in April 2022, after prices doubled to more than $100,000 per tonne due to the challenging commodity market conditions following Russia's invasion of Ukraine. The BoE confirmed in March that it had asked LME Clear to strengthen its governance arrangements, increase independence in management and governance and improve on its wider risk management, with a skilled person also being appointed to independently monitor, assess and report to it on LME Clear's implementation progress against remedial actions. The FCA also announced in March that it intended to launch an investigation into some of the LME's conduct and systems and controls in place in the period between 1 January and 8 March 2022.

Wholesale

Into 2024, financial risk management controls, particularly those related to financing transactions, trader controls and booking model oversight, will be an area of close regulatory attention – as will prudential requirements. Further significant failings by large institutions will likely lead to further investigation and enforcement activity. An early example of this is the PRA's January 2024 £57.4m fine to HSBC Bank plc and its UK ringfenced entity HSBC UK Bank plc for shortcomings in their implementation of the Depositor Protection Rules – essentially for misclassifying deposits as ineligible for FSCS protection. The action highlights the need to: (i) ensure separate entities, following restructuring (here, ringfencing), have sufficient resource for their specific regulatory compliance needs going forward; (ii) assign clear ownership of and senior manager responsibility for each area of regulatory compliance; and (iii) notify the PRA as soon as a potential issue is identified (even before preliminary findings are made – though this will involve applying specific judgment in every case).

Market conduct

Beyond the FCA censure of NMC Health Plc for market manipulation as a result of the issuance of false or misleading information (including as to its debt position) and its failure to declare related party transactions, we did not see the conclusion of any significant market conduct related enforcement action during 2023.



However:

> We have observed a marked increase in the number of requests for insider lists, chronologies and other information in relation to compliance by issuers with their continuous disclosure obligations and the accuracy of announced information as well as suspected unusual trading activity. Further enforcement action against listed issuers over the next 12-18 months is likely.

Wholesale

- There has been renewed focus by the FCA on the systems and controls in place at wholesale firms to identify, prevent, detect and report potential market abuse, including the arrangements in place to report suspicious transactions and orders. The FCA has identified the following as areas for continued focus and improvement: greater consideration of market abuse risks particularly in relation to non-equity asset classes; increased governance of market abuse surveillance arrangements, including the use of independent quality assurance; the use of more sophisticated surveillance to identify potential market manipulation; the need for robust investigation and disposition of surveillance alerts; and regular reviews of the market abuse risk assessments conducted by firms to assess the key market abuse risks faced by the firm.
- Similarly the FCA has been highlighting the need for wholesale firms to ensure that they have robust controls over the inside information handled by them include stronger adherence to the need-to-know principle, fewer permanent insiders, more robust systems and controls to record access to inside information, and robust procedures for the conduct of market soundings. On the latter topic, in October, the FCA published its observations on trading in the context of market soundings and minimising the risk of insider dealing and unlawful disclosure. The FCA also reminded Market Sounding Recipients (MSRs) that the market soundings regime does not protect them from committing insider dealing. MSRs must also independently assess whether they possess insider information that would prevent them from trading. We expect significant or persistent failings in this area to lead to enforcement investigations.
- HM Treasury and the FCA used a joint statement on the completion of its Criminal Market Abuse Regime Review (one of their commitments under the Economic Crime Plan 2019-22) to confirm the government's plans to repeal MAR and replace it with UK-specific legislation. The government will also consider changes to the criminal regime alongside any reforms to MAR through the Future Regulatory Framework Review.
- Other key wholesale conduct risks relate to personal account dealing controls and the identification/ management of other potential conflicts of interest; and the conduct of business on non-firm approved messaging systems. We expect these will continue to attract regulatory attention over the coming period.
- In relation to transaction reporting, the FCA used Market Watch 70 to confirm that it had seen "*significant progress*" from firms in this space. The FCA's general view is that data quality for transaction reports is good, reflecting investment made by the industry and its own ongoing engagement with firms. Interestingly, a recent freedom of information request revealed that the FCA has not opened any enforcement investigations in relation to transaction reporting since MiFID II was introduced in 2018.

Wholesale

In one of the year's more striking cases, the FCA published decision notices in May finding that Banque Havilland SA and three former employees of its London branch (including the CEO and a senior manager) acted without integrity by creating a document describing a potential strategy (which was not implemented) to harm the Qatari economy (see further below).

The FCA found that, regardless of whether the strategy as set out in the presentation was practicable or likely to be accepted by such representatives, it was "*a way of signalling to potential investors that the Firm was willing to countenance improper market conduct, in order to advance its interests*".

The FCA proposed to fine Banque Havilland £10m and to impose prohibitions and financial penalties of between £14,000 and £352,000 on the three individuals. Three of the four decisions have been referred to the Upper Tribunal.

As with the Julius Baer case, the Tribunal proceedings are likely to raise interesting questions about the characterisation and attribution of individual misconduct.

Financial crime

Whilst the overall number of enforcement outcomes fell in 2023, the FCA has continued to publish final notices for financial crime systems and controls failings. It is a theme to which the FCA has also returned to in several speeches.

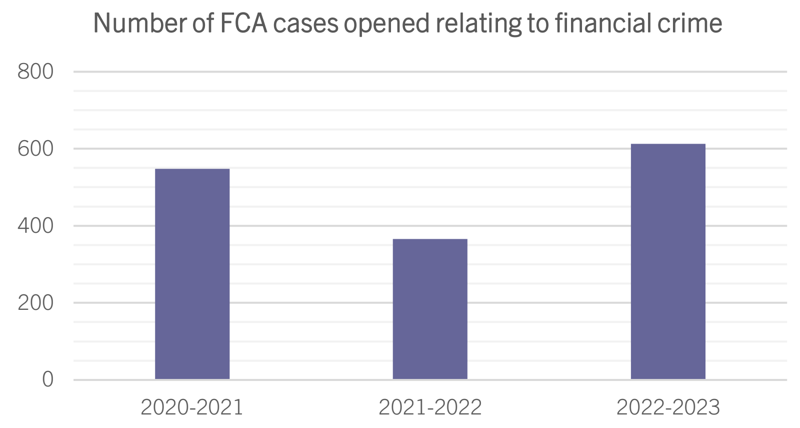
Developing areas such as cryptoassets present new opportunities for fraudsters and the FCA remains focused on policing the perimeter to prevent bad actors becoming authorised.

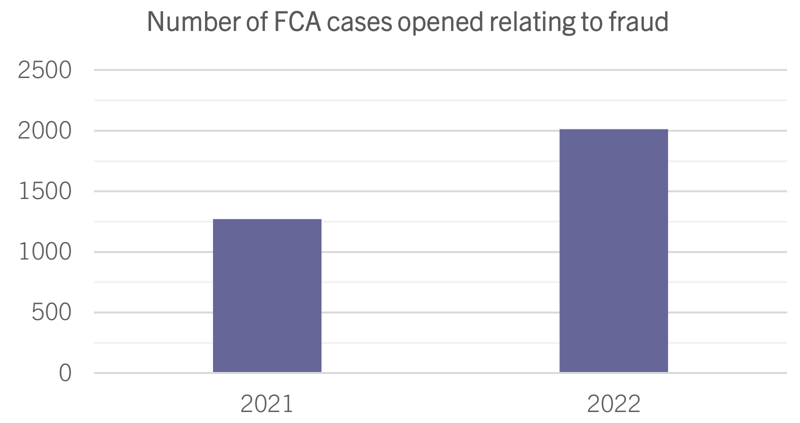
AML

The FCA began 2023 by fining Guaranty Trust Bank (UK) Limited £7.7m for serious weaknesses in its AML systems and controls, aggravated by its inadequate remediation following a 2013 final notice for similar issues and ensuing FCA supervisory engagement. Amongst more familiar themes, the final notice identified an abdication of responsibility for AML compliance in the first line and a culture that prioritised sales over compliance. The firm's voluntary imposition of restrictions on its business pending remediation was cited as a Step 3 mitigating factor when calculating the penalty.

A day later the FCA fined Al Rayan Bank PLC £4m for failings centred around the firm’s handling of UK inbound fund flows in higher-risk circumstances. The failings included a failure to apply appropriate Enhanced Due Diligence (**EDD**), reliance on due diligence undertaken in other states which did not meet the standards required by the Money Laundering Regulations, ineffective transaction monitoring, ineffective audit activity and a failure to respond effectively to concerns raised by the FCA.

In October, the FCA fined brokerage firm ADM Investor Services International Limited £6.5m for inadequate AML systems and controls. The FCA’s concerns included a lack of a formal process to classify customers by risk and weaknesses in procedures for conducting Customer Due Diligence (**CDD**) and EDD and ongoing monitoring of clients’ CDD and EDD





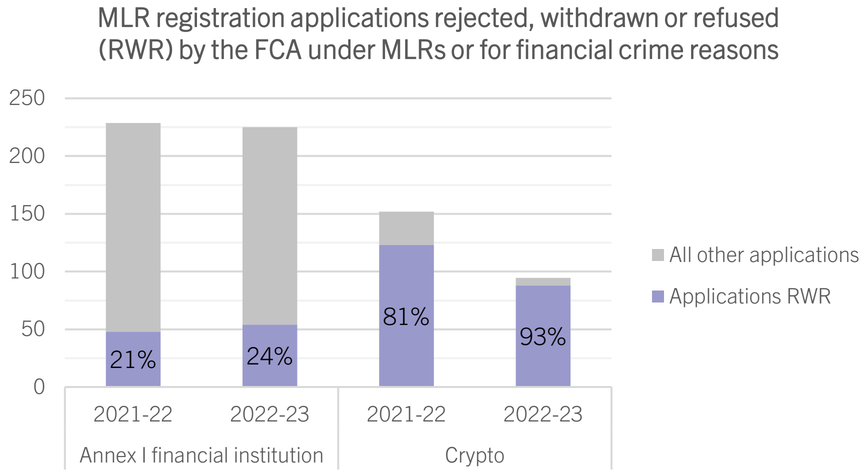
information. The case highlights the negative implications, from an enforcement risk perspective, of insufficiently addressing FCA supervisors' concerns during assessments and site visits. The FCA began the relevant period at the point it first raised concerns about the firm's systems and controls, only ending it once immediate remedial work was completed following a second FCA visit (finding that significant failings remained) and a business restriction voluntary requirement (**VREQ**) had been imposed.

We expect that weaknesses in AML systems and controls will continue to be a high focus area for enforcement investigations over the coming period – including the FCA utilising assertive supervisory intervention as well as criminal and civil enforcement powers in this area.

Sanctions

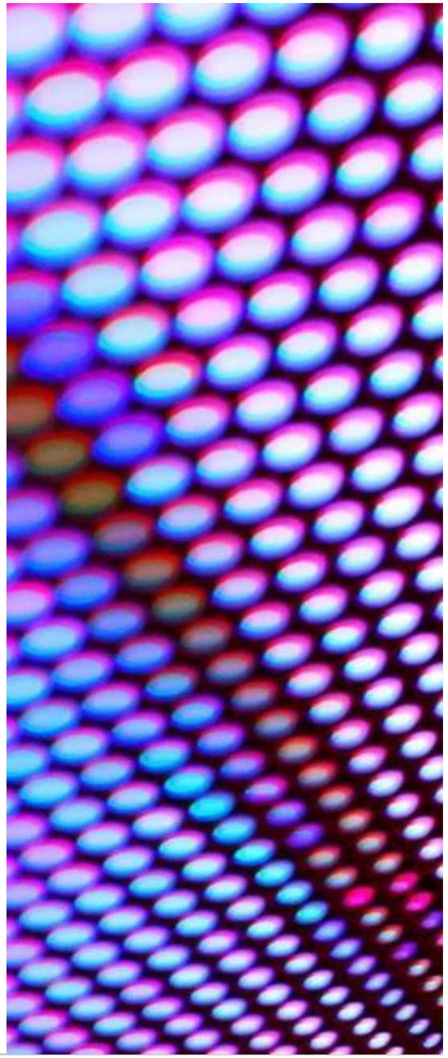
FCA concerns around firms' sanctions controls were clearly set out in its review of the sanctions systems and controls at 90 UK financial services companies, published in September. The FCA confirmed that it expects to be notified about any sanctions breaches by regulated firms at the same time as they are reported to OFSI. More broadly, the review outlined five key areas of concern:

- **Governance and oversight**: Some firms are still not able to show that they are providing senior management with sufficient information about their exposure to sanctions or are reliant on global sanctions policies which are not aligned with the UK sanctions regimes.



- **Skills and resources**: Some firms still lack adequate resources to ensure effective sanctions screening. Firms that have significant screening backlogs are at greater risk of non-compliance with sanctions obligations.

- **Screening capabilities**: The FCA saw some poorly calibrated or tailored screening tools, with some firms also too reliant on third party providers with ineffective oversight over them. Firms need to ensure their controls and governance are effective and tailored to the needs of their business, whether they outsource aspects of their procedures or not.



- **CDD and Know Your Customer (KYC) procedures**: The FCA continues to find instances of low quality CDD and KYC assessments and backlogs. This can increase the risk of firms not identifying sanctioned individuals, for example, by failing to identify connected parties or corporate structures that are sanctioned.
- **Reporting breaches to the FCA**: The FCA found that the timeliness of reporting potential breaches or relevant sanctions information was inconsistent across firms.

The FCA Executive Director for Markets and International, Sarah Pritchard, gave speeches in May and September to emphasise sanctions as an area of heightened FCA concern. Ms Pritchard challenged firms to consider how financial crime risks could be reduced when new products are designed and the extent to which controls are operating to deliver good outcomes for retail customers. The FCA is increasingly using synthetic data sets and technology to test firms' sanctions controls. It has signalled its willingness to use "*regulatory tools*" to deal with such issues, including forced business restrictions and enforcement actions.

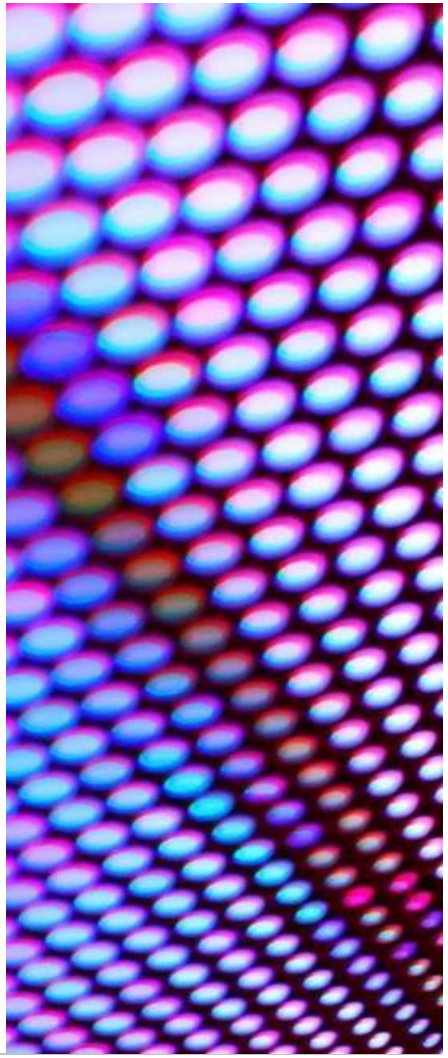
Cum-ex

June saw the FCA impose its fourth enforcement action for cum-ex related failings, and its largest penalty to date in this space, when it imposed a £17.2m fine for financial crime and AML systems and controls weaknesses against ED&F Man Capital Markets Limited (**MCM**). MCM enabled significant volumes of dividend arbitrage trading on behalf of clients, allowing clients to reclaim withholding tax (**WHT**). £20m of the WHT reclaims made by MCM's clients to the Danish tax authority were deemed illegitimate.

A fifth cum-ex action followed when the FCA fined Bastion Capital London Limited (in liquidation) £2.5m for breaches of Principles 2 and 3. According to the FCA, Bastion executed trading to the value of approximately £49bn in Danish equities and £3.5bn in Belgian equities on behalf of Solo Group clients, enabling them to allow the arranging of WHT reclaims in Denmark and Belgium. Whilst the FCA will often decide not to impose a fine where a target firm is in liquidation, on this occasion it chose to impose a fine and become a creditor of the firm.

Prosecutions

FCA criminal investigations to address fraud and police the perimeter continue. In April the FCA secured convictions of three individuals for investment fraud and one for trading without FCA authorisation. Cameron Vickers, Raheel Mirza, Opeyemi Solaja and Reuben Akpojaro made cold calls to members of the public, using pseudonyms, to convince them to invest with Bespoke Markets Group, a fake company. Various UK and offshore companies and bank accounts were set up to try to distance the defendants from the fraud and to launder money. In a separate FCA prosecution, Peter and Andrew Currie were sentenced in July to 5.5 years and 2.5 years imprisonment respectively for fraud and money laundering. The pair had conducted unauthorised business having fraudulently claimed on a website to be authorised and regulated by the FCA.



Tech and operational resilience

The most notable enforcement action in 2023 in relation to this topic was the PRA's final notice issued to TSB's former Chief Information Officer Carlos Abarca (discussed further below).

With new rules in both the EU and UK context set to take effect in 2025, in the coming year firms will need to upscale their systems and upskill staff to respond to the dynamically changing cyber threat environment and to maintain robust operational and technological resilience, including through effective oversight of third party suppliers.

In an interesting example of a failure that attracted the attention of multiple regulators, in October the FCA fined Equifax UK £11m following a 2017 cyber-attack against its US parent which resulted in the disclosure of data on almost 14m UK individuals. This decision came five years after the Information Commissioner's Office's (ICO's) £500k fine for the same incident.

The FCA concluded that Equifax UK failed to assess and address relevant risks of outsourcing some data handling to Equifax US. Equifax UK's arrangements with Equifax US allowed the latter to delay passing on details of the incident, affecting Equifax UK's customer communication and complaints handling. The UK entity also failed to correct its public statements about the incident in a timely way.

The decision demonstrates that a firm outsourcing crucial services to an intra-group entity – even its parent – should ensure robust oversight of the services that have been outsourced. It underlines the message in the Abarca case that senior managers need to verify the basis for assurances received from other firms about their adherence to relevant standards. The FCA found that the Security Executive relied upon an auditor's ISO certification of Equifax US's systems, rather than independently obtaining assurance that they met Equifax UK's needs.

Tech and operational resilience

Cyber-resilience

In a speech in October, Bank of England Financial Policy Committee (**FPC**) member Elisabeth Stheeman reminded firms that cyber-attacks remained the most prominent operational risk the FPC is monitoring. Firms are expected to be able to test both their resilience to withstand cyber security incidents, as well as their ability to respond to issues when they do arise before any material economic impacts occur (known as 'impact tolerance'). This is a specific concern in the retail payment sector, where the potential is particularly high for such attacks to cause harm to individuals. To avoid failings and subsequent enforcement action, firms need to have solid and well-rehearsed contingency plans in place, thinking in advance about steps that can be taken to mitigate unavoidable harm and engage effectively with the public, regulators and other stakeholders if a crisis does occur.

Concentration risk and critical third parties

In response to a growing concern about the concentration of reliance on a small number of third-party cloud, IT and other critical service providers, the BoE, PRA and FCA published a joint consultation in early December on proposed rules for the regulation of Critical Third Parties (**CTPs**). CTPs are firms that provide critical services to UK financial services firms and Financial Market Infrastructure firms (**FMIs**).

The proposed regime will only apply to firms that HMT designates as CTPs. HMT will designate a CTP if (in essence) a disruption to its services could threaten the stability of – or confidence in – the UK financial system.

The regulators estimate that HMT will designate 20 firms as CTPs. These CTPs would then be required to adhere to certain fundamental rules and requirements in relation to the conduct of their business, and would be subject to supervision and oversight by the financial services regulators, including information gathering, self-assessment and reporting requirements as well as powers of intervention and prohibition.

Similar requirements are being implemented in the EU through the Digital Operational Resilience Act (**DORA**).

The past year has seen significant developments for disciplinary actions under the SMCR by both the FCA and PRA. These provide welcome (if limited) guidance on what 'reasonable steps' may look like.

SMCR investigations constitute a rising proportion of all FCA enforcement investigations.

Given the number of enforcement investigations accompanied by actions against individuals in 2023 (many of whom have referred their decision notices to the Upper Tribunal) we expect to see more concluded outcomes against senior individuals within the next 12-18 months, potentially with significant implications for the nature and extent of regulatory risk faced by senior managers.

PRA

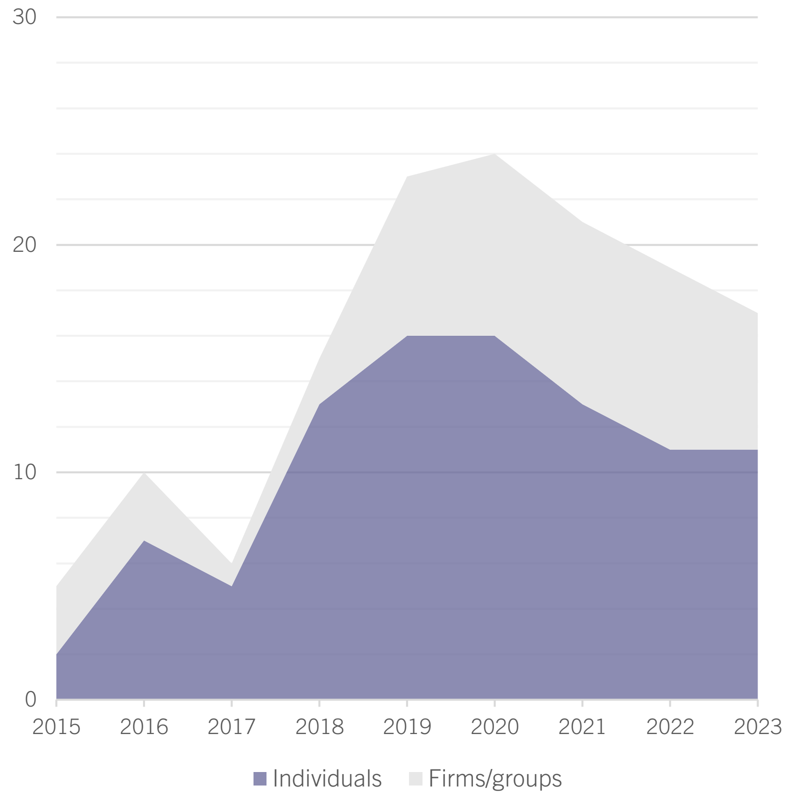
The PRA in particular is increasingly deploying the SMCR in an enforcement context.

In 2023 it fined former TSB CIO Carlos Abarca for failing to take reasonable steps in relation to identification and mitigation of risk relating to TSB's 2018 IT migration which resulted in significant service disruption, breaching the PRA's Senior Manager Conduct Rule 2 (regulatory compliance) (see further above). The PRA found that Abarca gave assurances to the TSB Board about third-party provider SABIS's preparedness without scrutinising the adequacy of the third and fourth party supplier assurances that were in place, particularly in the context of other service level breaches that had been experienced during the migration.

This trend is continuing in 2024 with the PRA fining former Wyelands Bank CEO Iain Hunter in relation to that firm's breaches of the Large Exposures Regime while he held a variety of SMFs.

Along with its use of the SMCR in enforcement, the PRA stresses the need for thorough and robust allocation of Senior Manager responsibilities for regulatory compliance. In its January 2024 £57.4m fine to HSBC it particularly criticised HSBC in respect of the PRA's finding that no senior manager was allocated responsibility for compliance with aspects of the Depositor Protection Rules.

Open PRA investigations
(end of reporting year Mar-Feb)



Individual accountability

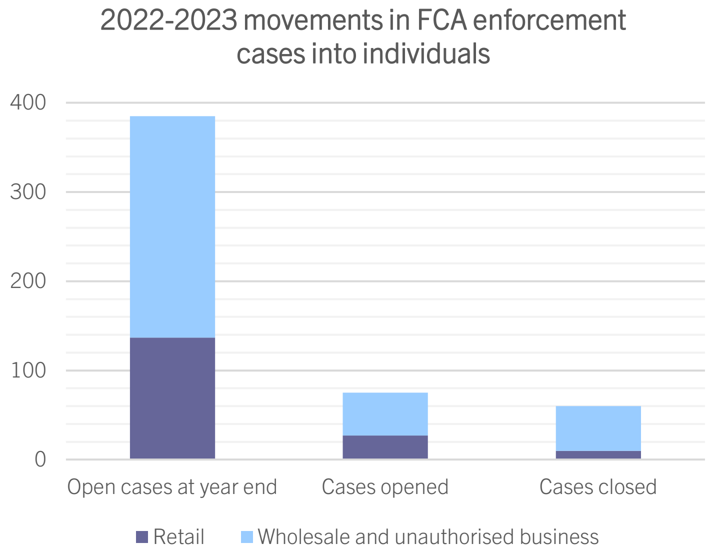
FCA

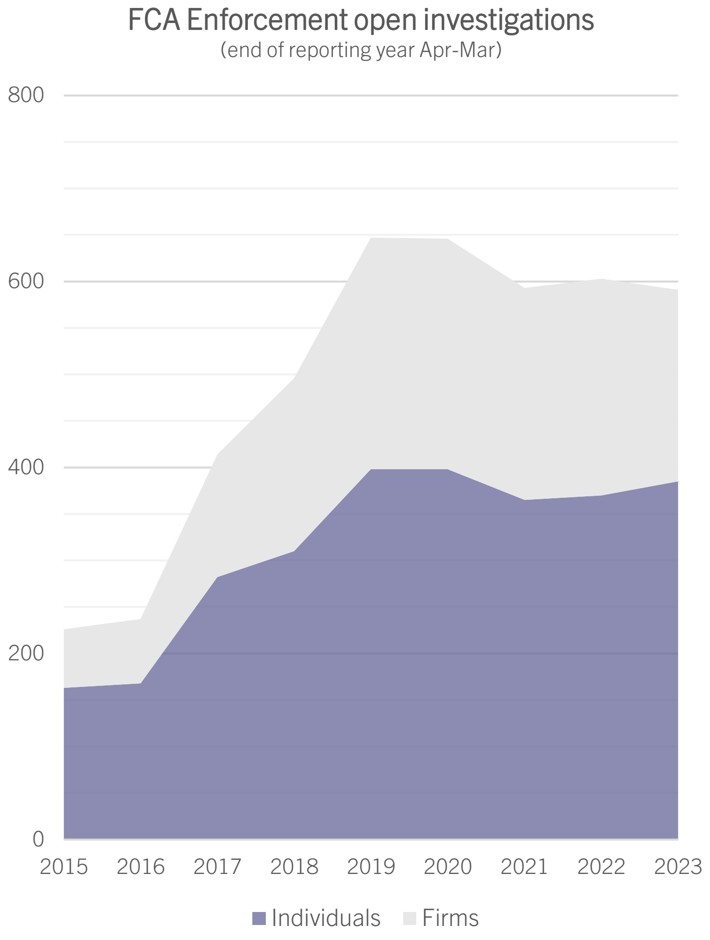
The FCA's most significant case in relation to an individual in 2023 was its decision notice to Jes Staley (former CEO of Barclays), which he has referred to the Upper Tribunal. The FCA proposed fining and banning him from holding a position of senior management or significant influence in the financial services industry, having found that he recklessly approved and failed to correct a letter from Barclays to the FCA containing misleading statements about the nature of his relationship with Jeffrey Epstein. The FCA found that Staley breached Senior Manager Conduct Rule 4 (disclosure to regulators) alongside Individual Conduct Rules 1 (integrity) and 3 (co-operation with regulators).

The Upper Tribunal decision may yield authority on the extent to which, in assessing a penalty, the FCA is entitled to include all unvested share capital which the individual reasonably expected to receive at the relevant time (with a contingency adjustment applied) when assessing income, or whether any shares that are later suspended should be excluded.

Barclays has confirmed that, in light of the FCA's decision, Mr Staley will have to forfeit up to £17.8m in deferred compensation, including the unvested shares.

These cases reinforce the regulators' willingness to pursue enforcement actions against Senior Managers, although the overall number of cases against Senior Managers continues to be lower than perhaps originally expected.





Individual accountability

Upper Tribunal

2023 also saw the FCA suffer some notable setbacks before the Tribunal in cases involving individuals which raised questions about its approach to contested cases.

Markos Markou, a sole director of small mortgage and insurance intermediary, successfully challenged the FCA's decision to fine and ban him for reckless or dishonest conduct in breach of APER Statement of Principle 1 (integrity). In response, the FCA said it believed that the judgment was "*incorrect and irrational*". It has been given permission to appeal. The FCA's appetite to appeal may have been increased by the Upper Tribunal's apparent efforts to make findings constraining the FCA's ability to make a fresh decision to ban Markou on more defensible grounds. If it stands, this judgment may also make it more difficult for the FCA to make findings of reckless lack of integrity in future, in particular around the extent of policy implementation failures and the lack of proactive monitoring by a senior manager of whether a business is sufficiently insured.

The FCA had fined Julius Baer International (**JB**) £18m in February 2022 in connection with certain FX transactions it executed for Yukos, which the FCA concluded contained a clear risk that the arrangements could involve JB facilitating or participating in financial crime. Significant reliance was placed in the JB final notice on the knowledge and actions of the three individuals against whom prohibition orders were made. All three individuals referred their prohibition orders to the Upper Tribunal. However, the FCA failed to demonstrate to the Tribunal's satisfaction that the individuals had acted recklessly or with a lack of integrity in relation to their role in the management and oversight of certain client relationships. The Tribunal concluded that whilst each of the individuals could potentially have taken greater care, there was insufficient evidence of a lack of integrity or recklessness on the part of any of them. The Tribunal was highly critical of the FCA's handling of the entire investigation, particularly its approach to disclosure, its reliance on investigations and findings of JB's own investigation, delays in progressing the investigation of the individuals and the FCA's failure to call key witnesses. Unusually, the individuals in question also secured a partial costs order from the Tribunal.

In both the decisions relating to the JB individuals and Mr Markou, the Upper Tribunal steered the FCA firmly away from pursuing weaker prohibition cases where disciplinary action was more suitable. This should lead to the FCA re-evaluating the appropriateness of pursuing enforcement cases in relation to very historic matters, and perhaps reducing the size of its overall caseload to enable swifter progress on the cases that it does take on.

Individual accountability

Both the JB and Banque Havilland (see further above) Tribunal references demonstrate the procedural challenges the FCA faces when trying to pursue concurrent cases against firms and individuals and managing third party rights.

In the Banque Havilland case, whilst two individuals have referred their decisions to the Tribunal, one has not. A further senior member of staff has asserted third-party rights. The Tribunal was asked to decide, as a preliminary issue, whether the FCA could proceed to issue a final notice against the individual who has not referred their decision notice, even though there was a claim to third party rights outstanding.

The Tribunal concluded that publication of a final notice would not interfere with its jurisdiction to determine the third-party reference – the final notice could be published with a note that the FCA's findings have not been considered judicially and are the subject of consideration insofar as they concern the individual claiming third party rights.

This mirrors the position taken in the JB case, but does create a risk of inconsistent findings – the final notice addressed to JB now has a note at the start indicating that it contains criticisms of three individuals, all of whom have now been exonerated by the Upper Tribunal.

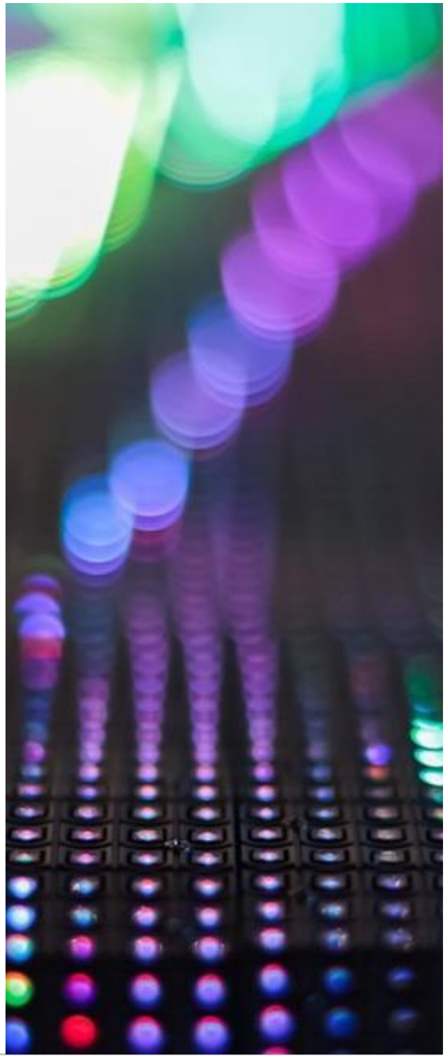
Non-Financial Misconduct ("NFM")

The PRA and FCA also released their long-awaited consultation papers on diversity and inclusion in the financial services sector, which include notable proposals on NFM. These include:

> Addressing the findings in the *Frensham* decision, proposed new guidance to reflect that both bullying and similar misconduct in the workplace and serious misconduct in a person's personal/private life is potentially relevant to fitness and propriety assessments, with the PRA similarly proposing to make clear NFM will be relevant when considering whether a person remains fit and proper.

> The FCA is also proposing to amend the scope of application of the Conduct Rules to encompass bullying, harassment and other similar conduct, as well as guidance on the distinction between private/personal life and conduct in scope of COCON and when NFM may breach Conduct Rule 1 (integrity) and Conduct Rule 2 (due skill, care and diligence).

It is likely that we will see some further enforcement decisions in relation to NFM. Our expectation is that these are likely to focus on (a) predominantly serious misconduct of the type that has previously given rise to prohibition orders (e.g. serious criminal convictions); and (b) in far fewer cases, decisions based on significant and persistent failings in the workplace.



Policy, practice and procedure

Despite the appointment of two new co-heads of enforcement, from a policy perspective 2023 was a quiet year for the FCA.

As noted earlier, the FCA continued to struggle before the Upper Tribunal and perennial issues around case management persist.

The PRA consulted on, then in early 2024 made, changes to its enforcement and penalty policies. The PRA's changes include several innovative new initiatives designed to streamline its investigation process.

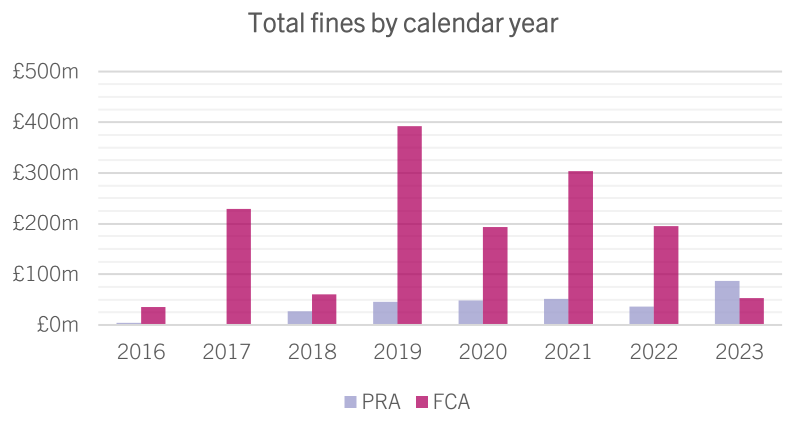
2024 will likely see the PRA steadily progress its enforcement work; in contrast, the FCA is likely imminently to reset its enforcement approach and refresh its enforcement case pipeline.

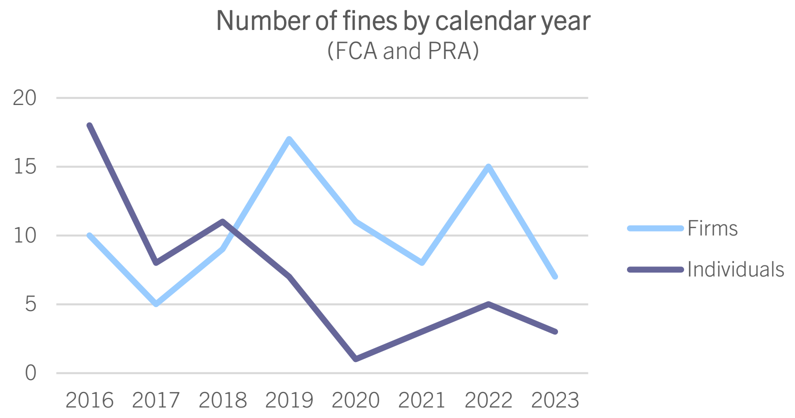
New FCA leadership

2023 marked the end of an era as we saw the departure of former FCA Director of Enforcement Mark Steward. His successors are Therese Chambers, who has held a number of senior roles within the Enforcement division previously, and Steve Smart, the former Director of Intelligence at the NCA. What messages are the new enforcement co-heads delivering?

> Therese Chambers wasted little time setting out her stall. She emphasised the importance of firms detecting and preventing harm early and offering proactive and generous redress (for which Quilter helped Lighthouse Advisory Services Limited avoid a fine). Her remarks reveal a tendency to see co-operation in binary terms: a firm either co-operates sufficiently to receive credit or is "*duck[ing] and div[ing] to avoid doing the right thing*", whereas the reality is of course more nuanced.

> Steve Smart has been more circumspect, but we did hear from him during the FCA's 2023 Annual Public Meeting. He talked about "*preventing investment fraud at source*" (largely, online), describing the need to take a "*team approach*" with regulated firms, other regulators, law enforcement, and bigtech – with intelligence sharing crucial to this. Therese Chambers has been effusive about her co-head's data and intelligence expertise, stating "*there really is nowhere to hide with him*".





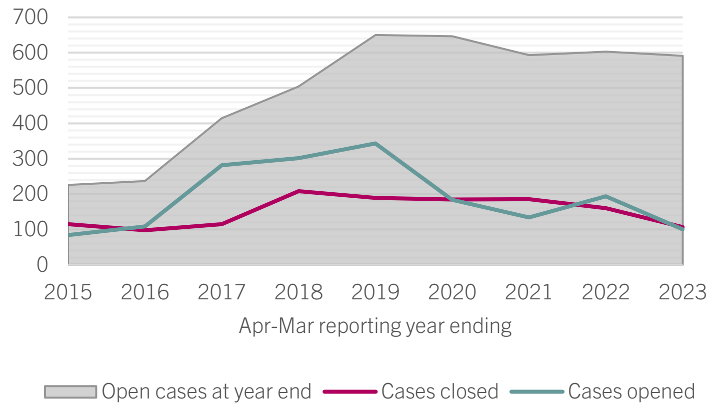
Policy, practice and procedure

It is fair to say that the FCA co-heads of Enforcement and Market Oversight face a significant challenge. The FCA continues to make slow progress in advancing its backlog of investigative casework, with overstretched investigative teams experiencing considerable delays and substantial staff turnover, against the backdrop of a challenging FCA internal transformation programme. The data shows that fewer cases were closed last year than in other years, and cases are taking longer to progress overall, with investigation times continuing to lengthen.

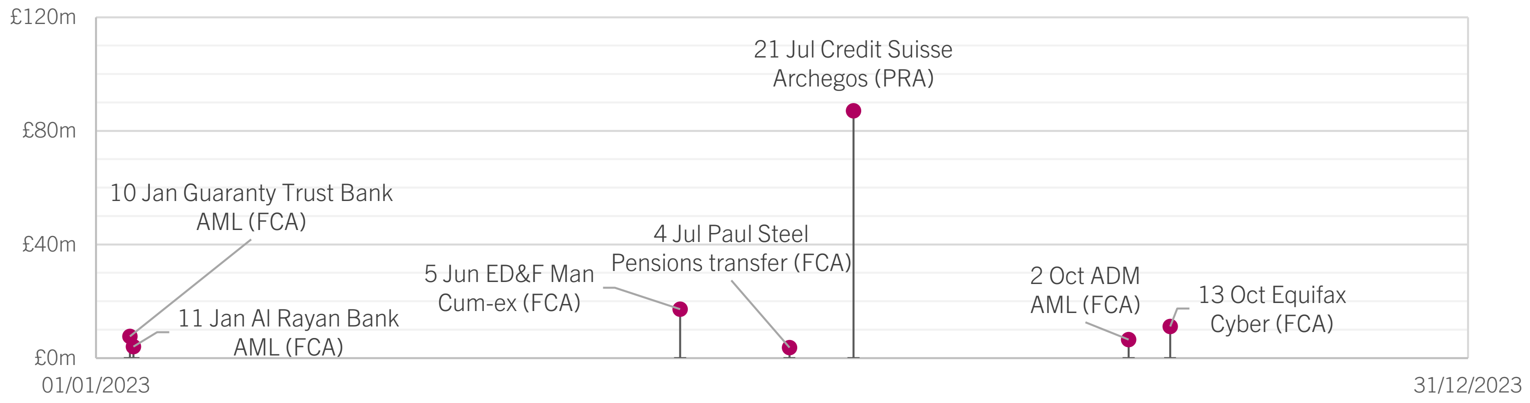
The National Audit Office reported in late 2023 that the FCA is facing implementation risks and continues to fall below its service targets. It exhibits a "*significant delay*" between identifying an issue and taking regulatory action, along with persistently high staff turnover in some areas. Further, its management information was found not to describe its target performance levels and was sometimes overly complex. In terms of enforcement specifically, there remains a sense that the FCA has failed to regain momentum post-pandemic.

Some of the FCA's recent attempts to conclude historic investigations have ended embarrassingly. 2023 saw a string of FCA defeats in the Upper Tribunal. In both the Julius Baer individuals and Markou cases, delays in progressing the initial investigations appear to have allowed the limitation period on disciplinary action for lack of competence to expire, requiring the cases to be re-framed as fitness and propriety prohibitions for lack of integrity. Similarly, the FCA's desire to pursue more innovative ways of achieving its objectives have sometimes backfired, with the Upper Tribunal finding in the *BlueCrest* decision that the FCA had not established a proper basis for imposing restitution requirements on the firm.

FCA Enforcement case movements



FCA and PRA fines >£2.5m in calendar year 2023



Policy, practice and procedure

A rethink and a reset

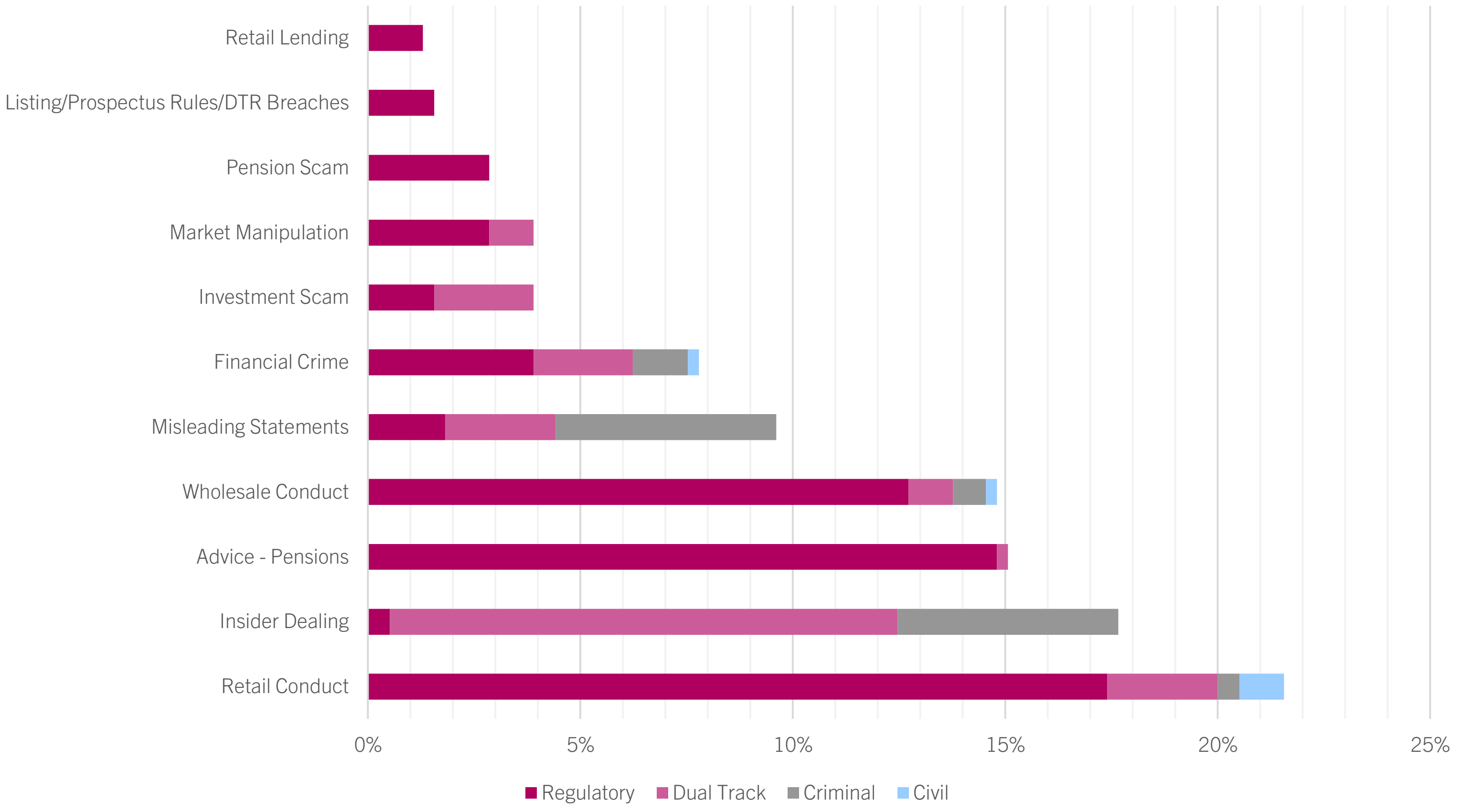
The FCA board is aware of the need for a change. It is now focused on "*how we develop an enforcement plan which targets the bad actors who cause the greatest damage*", according to FCA Chair Ashley Alder.

The first step is likely to be a clearing of the decks. We understand that the FCA is strategically triaging and closing a range of historic investigations, to provide space to implement some new approaches. The data for 2023 shows a slowing in the FCA case pipeline, with far fewer cases opened than in other recent years.

Chief among the FCA's new approaches is its focus on leveraging high-volume data analysis to intervene and prevent harm at scale. Its new "Path to Harm" model identifies "*early warning signals of a developing harm and the data we can use to turn those signals into actionable intelligence [to] identify earlier opportunities for interventions and action to be taken*".

The FCA's new focus on data may change the issues the FCA detects and the pattern of its interventions and enforcement decision-making. It should enable the FCA to identify sector-wide and systemic issues and matters arising within specific business units, which in turn may lead to swifter preventative interventions, perhaps on more limited information.

FCA Enforcement cases open by primary issue and case type
(at 1 Apr 2023; % of total; excl. Threshold Conditions and unauthorised business)



Policy, practice and procedure

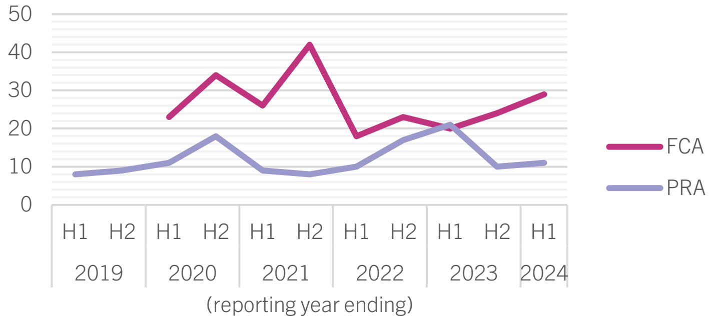
The FCA has already increased interventions at all stages of the regulatory lifecycle.

The FCA is policing its regulatory perimeter more aggressively to "*limit the ability of bad actors to enter our financial system*". One in four applications for authorisation now are withdrawn or rejected (up from one in 14 two years ago). Cryptoassets have been a particular focus, with 93% of applications for MLR registration rejected, withdrawn or refused last year. The FCA has also cancelled unused permissions having used automated techniques to identify target firms.

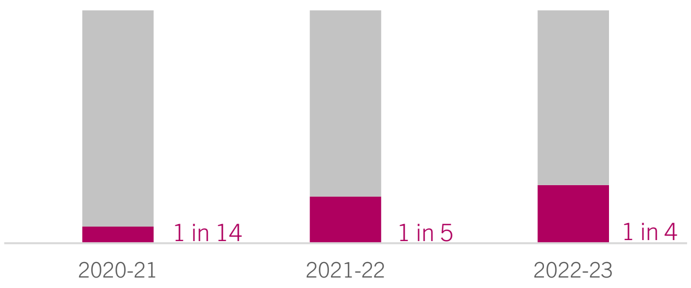
Skilled Persons

There appears to have been a gradual uptick in the use of Skilled Persons by both the FCA and PRA. The FCA is using the tool much more than before in the context of portfolio supervision firms, particularly in relation to governance, risk management and control issues. We are also seeing some modest increases in the use of the tool by the PRA, particularly in relation to risk management matters.

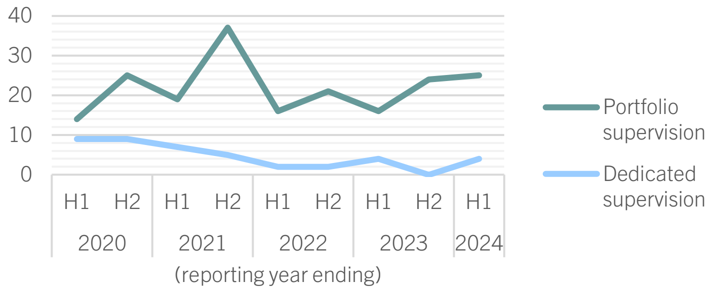
Number of Skilled Person reports commissioned per reporting half-year



Proportion of applications for FCA authorisation withdrawn or rejected



Number of FCA Skilled Person reports commissioned per reporting half-year: number in each supervision category



Policy, practice and procedure

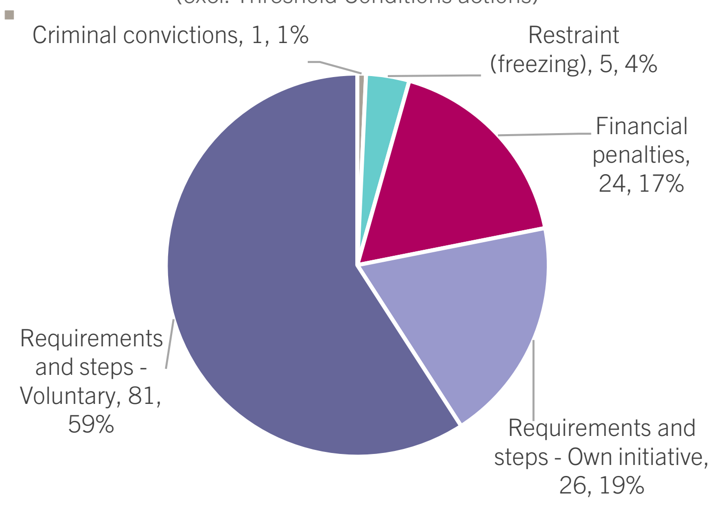
Requirements, permissions and other powers

The number of FCA supervisory notices, requirement notices and undertakings continues to grow year-on-year, along with the number of FCA VREQ/OIREQ cases. So much so that VREQ/OIREQ outcomes now dwarf financial penalties, restraint and confiscation.

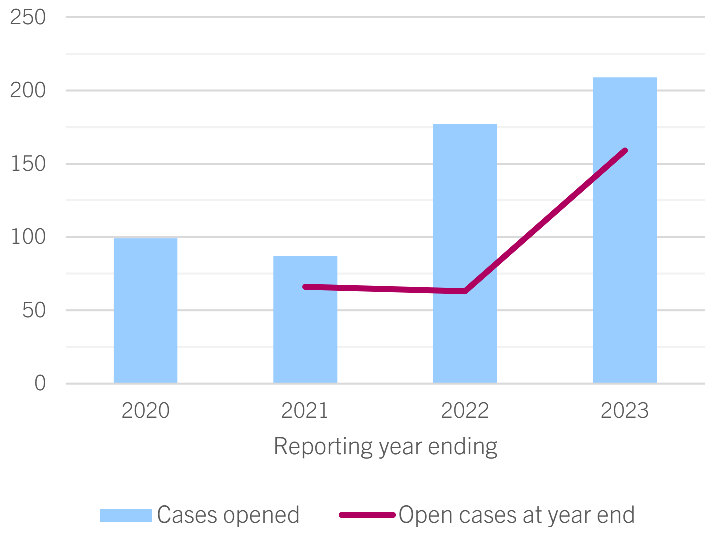
We expect this trend to continue in 2024. Although most VREQs and OIREQs are addressed to smaller firms, they still present a risk even for larger firms, who more typically may be required to give undertakings in lieu of a formal VREQ/OIREQ process, but who in any event are also on the receiving end of far more in the way of supervisory attention than at any time since the pandemic began.

The FCA is opening substantially more supervisory cases relating to financial crime and fraud, to address the significant growth in reported scams. FCA interventions on financial promotions also continue to rise quickly (see the Retail section of this note), and we expect will continue to do so in 2024. The FCA wants to maximise its operational efficiency and will be quick to take chances to intervene early in relation to larger promotional campaigns that present a risk of harm.

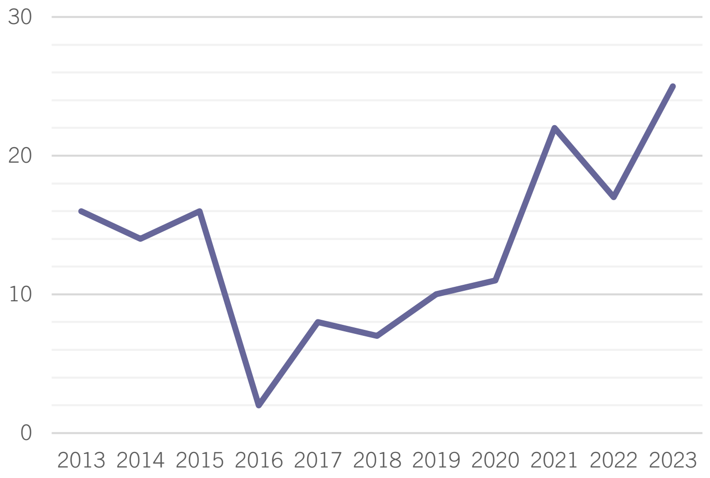
Number of FCA Interventions and Enforcement actions 2022-23
(excl. Threshold Conditions actions)



FCA Interventions cases - OIREQs and VREQs



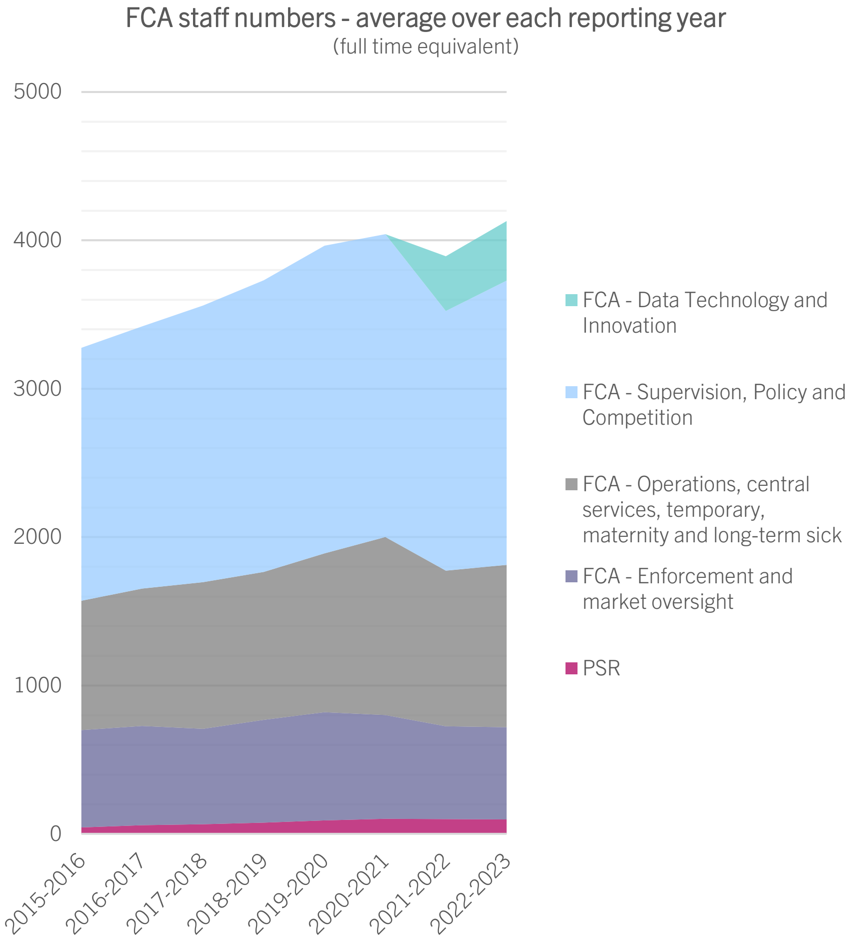
Number of FCA supervisory notices, requirement notices and undertakings (excluding benchmark notices)



Policy, practice and procedure

FCA resourcing

From a resourcing perspective, there is likely to be a modest rebalancing of Enforcement resource towards unauthorised business enforcement, but the Enforcement team remains heavily involved in supervisory interventions work. Its embedded Interventions team opens cases and makes interventions upon the FCA's Supervision, Policy and Competition Division (**SPC**) raising concerns. Meanwhile the FCA is establishing dedicated taskforces for specific interventions and enforcement areas. For example, it has formed the Financial Promotions and Enforcement Task Force (**FPET**) and a new department leading the cross-FCA strategy on Appointed Representatives and high-risk casework.



Policy, practice and procedure

PRA enforcement

Differences are appearing between the FCA and the BoE/PRA's approaches to enforcement. In January 2024 the BoE/PRA made major changes to their enforcement processes and financial penalty calculations – largely unaltered from their original proposals). The key changes:

> **Early Account Scheme (EAS)**: This allows firms and individuals to expedite the information gathering phase of a PRA investigation by giving the PRA a detailed factual account within six months of an investigation opening, which must be supported by a Senior Manager attestation. While potentially attractive to firms, there are potential complexities to be worked through. These include the interplay between a firm account and parallel investigations into individuals; the potential for significant PRA input into aspects of the firm's internal investigative process; and how the attestation process would operate in practice.

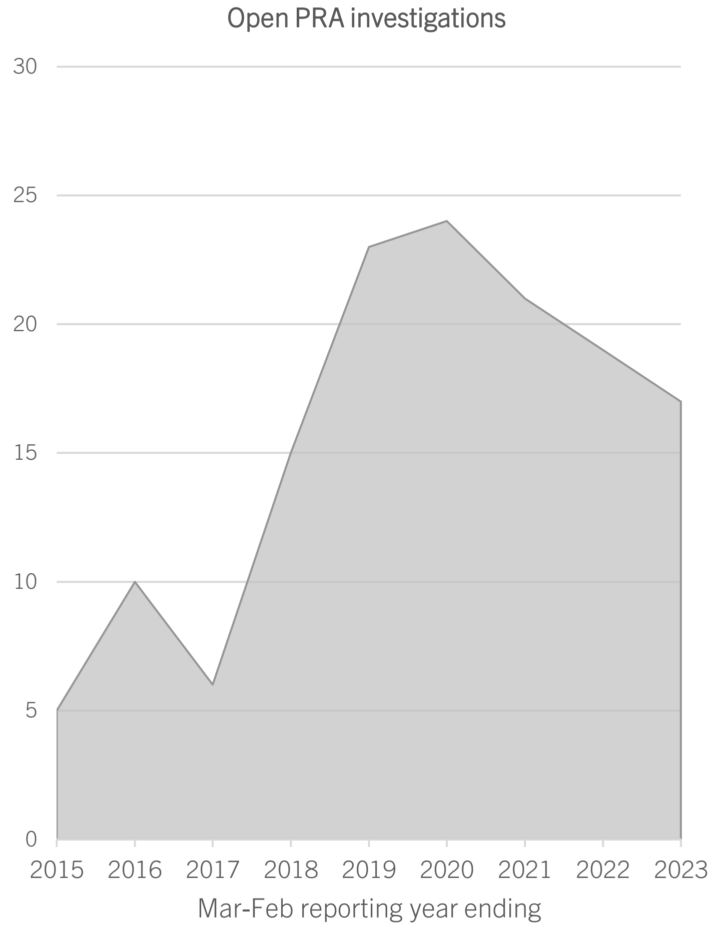
> **Enhanced settlement discount**: The PRA now offers a discount of up to 50% where the subject participates in the EAS, makes early without prejudice admissions and co-operates in a merit-worthy way. The challenge here is likely to be the substantial subjectivity built into the PRA's assessment criteria.

> **A "Step Two Starting Point Matrix"**: This major change, for firms, removes the current step two starting point of firm revenue with a seriousness multiplier applied. Instead, the matrix gives indicative ranges of actual figures for the penalty starting point by reference to: (1) the firm's impact categorisation; and (2) the seriousness of the breach. The PRA retains discretion; how it exercises this in practice will determine how effective this change is in making penalties more predictable and consistent.

> **Revising the Step Two starting point for individuals**: The PRA has aligned its step two starting point approach for individuals with the FCA's current approach for individuals. This should result in greater consistency particularly in joint enforcement actions.

> **FMI enforcement activity**: The BoE is updating its penalty policy for financial market infrastructures (**FMIs**) to give more clarity on its investigation and disciplinary processes, including a new ability for FMIs to negotiate a settlement. This development may foreshadow enforcement activity in the FMI space (there have not yet been any published FMI outcomes).

No doubt the FCA is watching all this closely – although its initial reaction has been lukewarm.



Your financial services interventions and enforcement team

Susana Cao Miranda
Partner, London
Tel: +44 20 7456 5529
susana.caomiranda@linklaters.com

Elizabeth Dowd
Partner, London
Tel: +44 20 7456
elizabeth.dowd@linklaters.com

Martyn Hopper
Partner, London
Tel: +44 20 7456 5126
martyn.hopper@linklaters.com

Nik Kiri
Partner, London
Tel: +44 20 7456 3256
nikunj.kiri@linklaters.com

Gavin Lewis
Partner, London
Tel: +44 20 7456 4209
gavin.lewis@linklaters.com

Clare McMullen
Partner, London
Tel: +44 20 7456 2129
clare.mcmullen@linklaters.com

Ben Packer
Partner, London
Tel: +44 20 7456 2774
ben.packer@linklaters.com

Alison Wilson
Partner, London
Tel: +44 20 7456 5725
alison.wilson@linklaters.com

Sara Cody
Counsel, London
Tel: +44 20 7456 3577
sara.cody@linklaters.com

Duncan Campbell
Senior Associate, London
Tel: +44 20 7456 4341
duncan.campbell@linklaters.com

London
One Silk Street
London EC2Y 8HQ
Tel: +44 207 456 2000

New York
1290 Avenue of the Americas
New York, NY 10104
Tel: +1 212 903 9000

Washington, D.C.
601 Thirteenth Street, N.W.
Suite 400 South
Washington, D.C. 20005

Paris
25 rue de Marignan
Paris F-75008
Tel: +33 1 56 43 56 43

Singapore
One George Street #17-01 to 07
Singapore 049145
Tel: +65 6692 5700

linklaters.com

A53609475. February 2024.