Feature

KEY POINTS

- Greater FCA enforcement of the perimeter seems likely.
- Whilst the law (for example ss 90/90A Financial Services and Markets Act 2000 (FSMA)) makes it possible for investors to take action directly against issuers for untrue or misleading statements published to the market about environmental commitments and performance, there are also a series of powers available to the FCA which it could use, particularly in markets-related cases, to investigate such issues and take action of its own.
- In relation to the new Consumer Duty, three areas of enforcement action seem likely to develop over time.

Author David Pygott

The future of FCA enforcement

2023 is a year of change for the Financial Conduct Authority (FCA)'s Enforcement and Markets Oversight division, with the arrival of two new Joint Executive Directors. At the same time, a series of legislative and policy developments are likely to have an impact on the enforcement landscape. In this article, David Pygott, a contentious regulatory specialist and partner in the Global Investigations team at Addleshaw Goddard LLP, considers what – beyond the FCA's own messaging to date – the future might hold for its enforcement activity.

FINANCIAL CRIME ENFORCEMENT: BEYOND AML AND ABC

During the tenure of the previous Executive Director, the Financial Conduct Authority (FCA) broke new ground in its enforcement of financial crime systems and controls, with its criminal prosecution of a bank for breach of the Money Laundering Regulations (MLRs). It also repeatedly secured regulatory enforcement outcomes against a series of firms for failures to comply with the MLRs and systems and controls requirements relating to financial crime.

It is no coincidence that one of the new co-Executive Directors of Enforcement moves to the FCA from the National Crime Agency (NCA), following a long career in intelligence collection. This raises the prospect of more coordinated work between the NCA and FCA. From the perspective of practitioners and financial services firms that are in the "regulated sector" for Proceeds of Crime Act 2002 (POCA) purposes, which must deal with both agencies on an ongoing basis, there are reasons to welcome this development.

At the same time, however, there is evolution in the types of financial crime case the FCA is willing to pursue. One of the key themes that has emerged in the last few years is the FCA's increased enforcement of the regulatory perimeter by way of criminal prosecution. Among a patchwork of powers which the FCA has to enforce the perimeter (depending on who was involved and what they did) are two long-standing provisions of Financial Services and Markets Act 2000 (FSMA) (ss 23 and 25). These in summary make it a criminal offence in the UK to carry on regulated activities while unauthorised or exempt, and for unauthorised persons to engage in financial promotion without the content of the promotions first being approved.

The way in which firms issue, and consumers access, financial promotions is changing rapidly. There have been substantial increases in the number of online frauds and scams. There has been debate (for example around the Online Safety Bill) over where responsibility for tackling such activity lies. The classic criminal justice system approach of prosecuting fraud offences is subject to resourcing limitations and is not adequate to meet the scale of the problem. There has been increasing political and public pressure on the FCA to act. It is clear (for example from the FCA's annual Perimeter Reports, and a series of victories at Southwark Crown Court) that the FCA is playing an increased role. However, it also faces challenges from the complex way in which the FSMA perimeter is defined.

Experience suggests that "unauthorised business" cases vary substantially in nature, and the public interest factors in favour of (or against) enforcement action are not the same in every case. In some cases, the unauthorised nature of the business is affected by the complexity of the perimeter itself: technical or otherwise inadvertent breaches, particularly by smaller or less sophisticated firms, or persons unaware of the consequences of their actions including some based outside the UK. On the other hand, there are cases where firms have deliberately adopted non-compliant business models that cross the perimeter resulting in substantial consumer detriment. As a matter of policy (and applying the tests in the Code for Crown Prosecutors) such cases must surely be dealt with in different ways.

The FCA will undoubtedly continue to take cases against firms with poor controls against financial crime. Some relevant reforms are also being made by the new Financial Services and Markets Act 2023. However, greater FCA enforcement of the perimeter seems likely.

ESG-RELATED ENFORCEMENT

The FCA is increasingly undertaking work around Environmental, Social and Governance issues (ESG). A list of its various initiatives is beyond the scope of this article, but for present purposes its work over the last few years includes: (i) embedding recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) into UK Listing Rules, in short requiring listed companies to make disclosures consistent with the TCFD's recommendations and confirm they have done so, or otherwise explain why they have not/what they are doing about it (see also TN/802.1); and (ii) introducing TCFD climate-related reporting obligations for some authorised financial services firms. A new ESG section of the FCA's Handbook has been created, which in particular requires asset managers to produce periodic climate-related reports.

The FCA has already engaged in some "social" ESG-related enforcement activity, in particular via its approach to non-financial misconduct (NFM) – enforcing in particular fitness and propriety obligations for those working in financial services. From a practitioner's perspective, NFM remains a live issue, as (even after litigation) the FCA's approach and outer limits of its powers remain controversial. However, to date, publicly it has done less "environment" ESG-related enforcement.

Biog box
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Whilst the law (for example ss 90/90A FSMA) makes it possible for investors to take action directly against issuers for untrue or misleading statements published to the market about environmental commitments and performance – so called "greenwashing" – there are also a series of powers available to the FCA which it could use, particularly in markets-related cases, to investigate such issues and take action of its own. These include, among others:

- powers to discipline relevant authorised financial services firms and individuals (such as asset managers and those who work for them covered by the Senior Managers & Certification Regime) for failures to comply with rules in the new ESG section of the Handbook;
- powers to review issuers' prospectuses, including a duty in s 87A FSMA not to approve a prospectus unless the FCA is satisfied that it contains the minimum information required by the Prospectus Regulation, which includes information about the "prospects" of the issuer;
- in serious cases, its ability to prosecute the offences in s 89 and 90 Financial Services Act 2012 which in short make it a criminal offence for a person to make false and misleading statements to the market, or dishonestly to conceal material facts, intending to affect investor behaviour;
- powers to bring enforcement action against those who commit market abuse by disseminating false and misleading information relating to financial instruments, when the person knew or ought to have known the information was false or misleading (UK MAR Art 12(1)(c));
- powers to discipline issuers for breaches of the Listing Principles and Listing Rules – not only the newer rules which mandate climate-related financial disclosures in annual reports (eg LR 14.3.27), but also the wide existing rule in LR 1.3.3R that requires an issuer to take care to ensure that any information it notifies to a regulatory information service is not misleading, false or deceptive and does not omit anything likely to affect the import of the information; and
- powers to bring enforcement action against issuers which fail to disclose inside information when required.

In principle, environment-related information, for example information about an adverse event or that a firm's environmental performance is not in line with statements previously made to the market, could be caught by the current disclosure regime (in particular Arts 7 and 17 UK MAR).

Alongside these powers, ongoing work by government and other agencies, particularly IOSCO, the IFRS Foundation/ISSB, and the Financial Reporting Council, could have an impact on the FCA enforcement landscape. For example, changes to international sustainability reporting standards will likely feed through into what listed companies must disclose to the market, and consequentially into non-compliance for which (in the UK) the FCA is one responsible enforcement authority.

The FCA has issued some messaging to the market around this already, for example by way of its July 2022 Review of TCFD disclosures by premium listed companies, and Primary Market Bulletin 42 (published in December 2022) concerning its ongoing monitoring of climate-related disclosures. In both of these reviews, the FCA identified what it saw as common gaps or failings.

In light of the above, the growing significance of ESG issues to investors, and the tension between requirements to make accurate market disclosures (on the one hand) and the complexity of the work, limitations in data and methodologies, and the level of judgement required to produce the disclosures (on the other), future FCA enforcement action in this area seems likely.

ENFORCEMENT OF THE NEW CONSUMER DUTY

The first tranche of regulatory rules imposing the FCA's new Consumer Duty came into force on 31 July 2023. The FCA has sent clear signals about early enforcement of these, including a reference in its Business Plan for 2023-24 to the creation of a new "Interventions" team within its Enforcement and Markets Oversight division "to enable rapid action where immediate consumer harm is detected". The FCA is adopting a data-led strategy and reporting to the regulator is a fundamental aspect of the regime.

Some of FCA's enforcement of the new Consumer Duty may quickly follow its introduction, however not all will. Three areas of enforcement action seem likely to develop over time.

First, there is likely to be significant enforcement risk for firms that have not got to grips with the new regime at all, have not carried out any implementation projects, or who maintain that they have but whose customer data suggests that no meaningful change has occurred as a result.

Second, critical aspects of the regime (for example: "good outcomes", "good faith", "foreseeable harm", "fair value" and "customer understanding") are open textured. There has been concern during the implementation phase – despite FCA publishing further materials intended to assist firms – over exactly what standard of behaviour the new regime will require after it comes into force. In reality, as part of their implementation projects, firms have been required to take a view. In the circumstances, it seems likely that, over time, differences of view will emerge between the FCA and firms who have engaged with the regime and believe they have implemented it properly, with enforcement action a possible consequence, especially for firms who stand their ground. These types of enforcement action may take longer to emerge.

Third, the Consumer Duty regime comes with reporting obligations (including under Principle 11). The FCA has been messaging strongly that its approach is increasingly data-led. Firms that do not adhere to these reporting requirements are potentially at risk on that basis as well.

From a legal perspective, FCA enforcement action in this area seems likely to be taken on familiar bases: a combination of the Principles (including new FCA Principle 12), the new Handbook rules that create the Duty, and the underlying provisions of FSMA that grant the FCA powers to investigate and discipline authorised firms and those who work for them. ■