Pinsent Masons

Financial Services: Regulatory Risk Trends

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BUSINESS WITH LAW AT THE CORE

Welcome…

… to this quarter's 'Financial Services: Regulatory Risk Trends' – Pinsent Masons' update on some of the 'hot topics' our financial services lawyers think you should know about.

This edition comes at a time of some cause for economic optimism, with the prospect of falls in the energy cap, inflation and interest rates, albeit against a backdrop of uncertainty with an upcoming general election and continued cost-of-living pressures. In that economic context, the FCA has set out the final piece of its 3-year strategy in the form of its 2024-25 Business Plan. The Plan is the cornerstone of the regulator's efforts to promote the growth of the UK financial sector while remaining assertive in securing good outcomes for consumers. Firms should prepare for the FCA to test Consumer Duty compliance in the run-up to 31 July, the deadline for completing reviews of closed-book products, with scheduled multi-firm work focusing on fair value and customer vulnerability.

In terms of the wider regulatory landscape, the government intends to regulate the provision of ESG ratings, while the Bank of England is considering changes to its decision-making processes to bring greater alignment with the FCA and reforms to its core settlement system (RTGS). HM Treasury is also consulting on enhancing the resolution process for small banks following the collapse of SVB.

More generally, the FCA has shown an interest in financial promotions, financial crime and market abuse, with the advice, consumer investments and insurance sectors being areas of particular focus. The overall picture is that firms will need robust systems, controls and technology in order to expand or consolidate their FS businesses, as well as mitigating regulatory risk where possible.

We hope this publication is useful to you, your stakeholders and your businesses and we look forward to providing you with our views and insights on these matters as they develop further over time, together with any new developments. In particular, this edition has been accompanied by our inaugural "Regulatory Risk Trends Conversations" webinar where key contributors shared additional insights and analysis on the topics in this publication. Thank you to those who attended and, if you missed it, we will be delivering another "Regulatory Risk Trends Conversations" webinar later in the year to accompany the next quarterly publication. We will send out invites to the mailing list, so please keep your eyes peeled.

Best wishes,

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Jonathan Cavill considers the FCA's latest Business Plan and a consultation on publicising investigations.

FCA BUSINESS PLAN

In a nutshell…

The FCA's Business Plan for 2024-2025 is the final part of the regulator's 3-year strategy, a flagship programme launched by Nikhil Rathi in 2022 to enhance the standing of the FCA and UK financial sector by reducing and preventing serious harm, setting and testing higher standards, and promoting competition and positive change.

Further detail…

The Plan highlights work to address the FCA's 13 public commitments, which are structured in two tranches. The three priority areas are reducing and preventing financial crime, putting consumers' needs first, and strengthening the UK's position in global wholesale markets, with a further 10 focus areas, such as improving the redress framework and dealing with problem firms.

A major theme of the FCA's Business Plan is securing good outcomes for customers in the run-up to 31 July 2024, the deadline for completing Consumer Duty reviews for closed-book products. The regulator plans to look at unit-linked pensions and long-term savings products to test the transparency of charges, as well as how swiftly insurers respond to claims.

Another key feature of the regulator's consumer protection work concerns customer vulnerability. The FCA has already announced a review of the treatment of customers in vulnerable circumstances, covering areas such as firms' understanding of consumer needs and product/service design.

Key takeaways…

The 3-year strategy and Business Plan are typical of the FCA's more assertive approach to securing market integrity and tackling harm to customers. The following areas are likely to come under the spotlight:

- Financial crime – firms will need robust systems and controls to address the risks of money laundering, fraud and terrorist/proliferation financing to which their businesses are exposed. Firms will be expected to show how they use AI and customer communications to detect fraud and reduce losses to consumers.
- Resolution and resilience – firms must have plans to ensure minimal disruption in the event of their failure or failures by critical third parties. In particular, relevant firms like banks and insurers must have performed mapping and testing by 31 March 2025 so that they are able to remain within impact tolerances for important business services.
- Appointed representatives – the regulator continues to see principal firms and ARs as potential drivers of mis-selling and customer harm. Firms looking to become principals or expand their AR networks can expect robust challenge by FCA Authorisations and Supervision, with a focus on due diligence and monitoring in relation to ARs.

ENFORCEMENT REFORMS

In a nutshell…

On 27 February 2024, the FCA published a Consultation Paper CP24/2 on its plans to amend its existing enforcement processes by increasing the publicity given to the opening, progress and closure of investigations.

Further detail…

In an accompanying speech, Therese Chambers, the regulator's Joint Executive Director of Enforcement and Oversight, emphasised that the FCA wants to deter harm, drive accountability on the efficiency and pace of its investigations, and reduce delays between misconduct and a penalty being imposed, in order to boost confidence in the markets.

At present, the FCA publishes minimal information about its open enforcement investigations or those which do not lead to any action (unless there has already been public discussion about them, as was the case with investigations on treatment of longstanding insurance customers). However, under the regulator's proposals, public announcements would be made more regularly when enforcement investigations are opened. In its consultation, the FCA envisages an announcement would contain:

- the identity of the subject of the investigation;
- the industry sector and regulatory or legal provisions to which the investigation relates;
- a summary of the suspected breach, failing or other misconduct being investigated; and
- a statement that the opening of an investigation does not imply that the FCA has reached a conclusion that there has been a breach, failing, or other misconduct unless it is inappropriate to do so (e.g. where there has already been relevant supervisory action).

The FCA has said that the decision to make an announcement will be made on a case-by-case basis, with consideration to be given as to whether it is in the public interest to do so. It is also unlikely that the identity of individuals under investigation will be announced.

Key takeaways…

The FCA's proposals are part of its strategy to show it is taking appropriate steps to combat market abuse and to protect consumers. Under the proposals, firms face the risk of adverse publicity at a much earlier stage when under investigation and, as a result, risk suffering reputational damage. This could be particularly damaging where firms are subsequently found to have committed no wrongdoing. Responses to the consultation are due by 16 April 2024, with the FCA set to publish a policy statement and feedback statement thereafter, so firms should ensure that their responses are submitted promptly.

Iain Sawers looks at a recent speech from the FCA and the regulator's work in relation to GAP insurance.

CONSUMER DUTY & FAIR VALUE

In a nutshell...

Earlier this month, the FCA's CEO, Nikhil Rathi, delivered a speech on how the FCA sees outcomes-based regulation operating, with a particular focus on the Consumer Duty and fair value.

Further detail...

The FCA continues to emphasise its expectations, which are enshrined in the Duty, that firms should be proactive in identifying and addressing concerns. Firms that act in this way will be looked on favourably by the FCA, even if mistakes are made in the Consumer Duty implementation process.

Building on the FCA's theme of "doing the right thing", Mr Rathi confirmed that the FCA is not seeking to 'trip firms up' with technical breaches of the rules. Instead, it will give firms time to act where they identify concerns, e.g. with the value of products. However, the regulator will not hesitate to move to firmer intervention if firms do not respond in an adequate way.

On the issue of fair value more specifically, Mr Rathi made it clear that the FCA does not want to regulate prices just as it does not want to restrain profits for well-run businesses. Historically, it has only acted on price where there were manifestly unacceptable outcomes even with competition.

In an insurance context, Mr Rathi highlighted the FCA's call for premium finance products, used by around a third of motor or home insurance customers, to be more reflective of the costs and credit risk involved, not least as many of these customers are amongst the most vulnerable.

Key takeaways...

The mood music coming from the FCA on fair value is relatively encouraging as it looks to soothe business concerns about the regulator's expansive role when it comes to interventions on fair value. However, this should not be taken to mean that the FCA will be passive where tangible customer harms may arise, especially when it comes to vulnerable customers. That much has already been demonstrated by the FCA's past interventions on issues like price-walking. Firms will therefore need to remain alert to those insurance products and customer journeys that risk exposing customers to costs which are difficult to justify. Not only will the FCA be keeping watch, but so too will the FOS, which will likely use the Consumer Duty as a further 'hook' on which to 'hang' its decisions when it comes to assessing fair value.

GAP INSURANCE SUSPENSION

In a nutshell...

On 9 February 2024, insurers agreed to pause sales of Guaranteed Asset Protection (GAP) insurance at the FCA's request following concerns over the levels of fair value that the product offers to consumers.

Further detail...

GAP insurance is common in the motor market, covering the difference in value between a vehicle's current market value and its purchase price.

This news follows the production of the FCA's Fair Value Measures Data for 2022 which revealed only 6% of premium amounts are paid out in claims for GAP Insurance products. This statistic, in addition to commission rates of up to 70% for these policies, prompted the FCA's September's Dear CEO letter which demanded evidence of action plans from GAP insurance firms to address fair value issues and comply with the Consumer Duty.

The resulting pause in sales has been agreed with firms covering 80% of the GAP insurance market, with further engagement across the remainder of the market to follow. During this cessation of sales, firms may not engage new GAP distributors, and must revise their approaches to resolving fair value failings.

Commenting on the announcement, the FCA's Executive Director of Consumers and Competition (Sheldon Mills) welcomed the agreement and reiterated that the FCA will '*work closely with firms… to resolve these issues and ensure customers are getting fair value products that meet their needs*'.

Key takeaways...

The action taken in relation to GAP insurance is one of the first examples of the FCA's Supervisory approach to achieving compliance with the Consumer Duty. This should serve as a warning to firms that the window for ensuring current products comply with the Duty has closed, and products that do not offer fair value to customers are at risk of being suspended.

Firms may take some comfort from Sheldon Mills' suggestion that the resolution of this issue will be a result of a collaborative process with the regulator. To avoid the cost and reputational damage of further Supervisory actions like Skilled Person reviews or Enforcement investigations, firms should be prepared to show the regulator evidence of how fair value has been achieved, taking into account all charges and benefits to consumers. Firms should also consider offering proactive redress for consumers sold products which do not offer fair value.

Colin Read reviews the FCA's data on financial promotions and a speech from Andrew Bailey.

FCA FOCUS ON FINANCIAL PROMOTIONS

In a nutshell...

The FCA has been actively targeting financial promotions to ensure they are clear, fair and not misleading, with a view to protecting consumers and maintaining market integrity. The regulator has recently published data setting out how it has used its powers in this area.

Further detail...

In 2023, the FCA intervened to ensure that over 10,000 financial adverts and promotions were withdrawn or modified, with 1,004 promotions amended or withdrawn in Q4 alone. The figures for 2023 represent a 17% increase compared to the previous year.

The regulator also issued 2,285 alerts, with 793 alerts in Q4 2023 alone, regarding unauthorised firms and individuals to warn consumers against scams, with approximately 6% of these relating to clone scams.

The majority of the FCA's financial promotion rules for cryptoassets went live on 8 October 2023. The rules require financial promotions to be clear, fair, and not misleading, with firms being required to display clear risk warnings, disclose the firm's regulated status, and cease promoting any form of incentive to invest. Using new powers, the FCA has issued 450 consumer alerts between 8 October 2023 and 31 December 2023. The FCA's cryptoasset financial promotion rules came fully into force on 8 January 2024, and the regulator is conducting reviews to test the level of compliance.

Key takeaways...

Firms must view financial promotions (like all aspects of their businesses) through the lens of the Consumer Duty. In particular, the regulator will expect firms to show they fully understand any investment products being promoted, including their pricing and distribution arrangements, with a focus on ensuring they are suitable for their target markets and in the best interest of UK clients. Firms should consider likely consumer behaviour and biases, and not include features like binary or repeated questions in promotions or customer journeys more generally which could be seen to guide or steer people towards buying a financial product.

Firms also need to be mindful of the scope of the financial promotion requirements. These apply to any promotions by a firm or its affiliates/introducers, which might include blogs, webinars or social media posts by influencers. Firms therefore need to maintain robust systems and controls across their communication channels, and take prompt steps to identify and remediate non-compliance.

BOE MACROECONOMIC TRENDS AND STRATEGY

In a nutshell...

Andrew Bailey spoke recently about the banking sector and its future, highlighting the resilience of the UK banking system, as well as challenges in relation to the optimal level of reserves, and the speed and scale of runs on banks.

Further detail...

Mr Bailey argued that post-2008 reforms have made banks more resilient and stable, and that capital requirements are broadly aligned across jurisdictions. He noted that net interest margins of UK banks have returned to more normal levels, and that demand for credit is expected to increase.

A particular focus of the speech was on liquidity. Mr Bailey observed that the Liquidity Coverage Ratio (LCR) requires banks to hold a sufficient stock of high quality liquid assets in normal times to survive a significant stress scenario lasting 30 days, combining idiosyncratic and market wide shocks. Major UK banks today hold £1.4 trillion of high quality liquid assets, which corresponds to an average of 149% of their LCR. Mr Bailey suggested that it would be appropriate to supplement the existing liquidity regime with more ready access for banks to liquidity insurance at the Bank, alongside more targeted adjustments to the liquidity regime, e.g. for firms with more vulnerable business models.

Mr Bailey explained that the level of reserves held by firms at the Bank has increased significantly due to quantitative easing, and that he expected it to settle at a higher level than before the 2008 financial crisis. He also reflected on the last year, when some banks based overseas (e.g. Silicon Valley Bank) experienced runs which were accelerated in speed and effect due to digital technology. Mr Bailey reiterated that the answer to this problem is for more UK banks to supplement their liquid asset holdings with efficient and extensive access to the liquidity facilities provided by the Bank of England, as well as holding larger reserves at the Bank.

Key takeaways...

Mr Bailey's comments on capital, liquidity, and interest rates are a useful indication of the likely focuses for prudential regulation in 2024, as well as the approach of PRA Supervision. Banking firms should consider increasing their capital reserves/ensure they have access to the Bank's Sterling Monetary Framework (SMF) liquidity insurance facilities in advance of future stress tests. Banks should also ensure they are operational resilient, and have robust systems and controls in relation to ring-fencing, account classification and resolution, or risk further enforcement action.

Elizabeth Budd looks at recent FCA letters on ongoing financial advice and treatment of cash balances.

FINANCIAL ADVICE ROUNDUP

In a nutshell...

The FCA has written to around 20 of the largest financial adviser firms and requested information about the delivery of their ongoing services, for which clients continue to be charged after advice has been given.

Further detail...

The FCA asks in its survey whether firms have assessed their ongoing services in response to the introduction of the Consumer Duty, and whether they have made any changes as a result. In addition, the regulator is asking for firms' data on the number of clients due a review of the ongoing suitability of the advice as part of the service, and how many received that review. Further, the FCA has queried how many clients paid for ongoing advice but had their fee refunded as the suitability review did not happen.

The information request follows the FCA's publication of its strategy in 2021 to support a thriving consumer investment market, as well as its portfolio strategy letter in December 2022, which set out its concerns that advice firms were not adequately considering the relevance, nature and costs of ongoing services for their clients. The FCA also explained how advice firms should approach the Consumer Duty in January 2023, and raised concerns in a Consumer Duty webinar at the end of last year that some consumers appeared to be paying for services like annual reviews but were not receiving them.

The regulator has stated that the information is being gathered to assess what, if any, further thematic work it may undertake in this area and forms part of the FCA's wider efforts to raise standards across the financial services sector so people can invest with confidence. Once firms' responses have been considered, the FCA has confirmed it will provide a further update.

Key takeaways...

As the Consumer Duty requires firms to deliver products and services that meet consumers' needs and provide fair value, firms should be mindful when applying ongoing charges, particularly where no service may ultimately be provided, as this could be seen as an indicator of poor value and result in regulatory intervention. Further, the findings of the FCA's survey have potential to apply more widely, notably to pensions or investment firms carrying out their back-book reviews under the Consumer Duty.

CONSUMER SAVINGS AND INVESTMENTS

In a nutshell...

In December 2023, the FCA issued a Dear CEO letter addressing its concerns with the retention of interest on retail customer cash balances by investment platforms and SIPP operators in light of the Consumer Duty (CD).

Further detail...

As is set out in the FCA's letter, evidence that firms are complying with the CD should cover the following outcomes: products and services that are fit for purpose; price and value; consumer understanding; and consumer support.

The FCA highlighted its concern that treatment of interest on customer cash balances is not in line with the CD, and identified several themes, including:

- retention of interest earned by firms on customer cash balances (which is likely not in line with reasonable expectations of customers, is not in good faith and does not provide fair value to consumers);
- platform fee charges on customer cash held by firms (resulting in potential 'double dipping', where both interest is retained and a fee is charged on customers' cash); and
- varying quality of disclosures to customers on retention of interest (inhibiting consumer understanding).

Key takeaways...

In order to address its concerns, the FCA has set outs its expectations of firms to ensure they deliver good outcomes in line with Principle 12 and PRIN 2A and meet the CD outcomes (in particular, of price and value and consumer understanding). Firms should:

- review their approach to retention of interest under the CD and take action to address the concerns noted above, updating terms, conditions and communications with customers accordingly;
- ensure their approach represents fair value for customers (considering decisions to retain a portion of interest in Fair Value Assessments and, where retention is to cover the cost of a cash management service, ensure the amount retained is reasonable in relation to the costs of providing the service); and
- cease any double-dipping,

Firms will need to have evidence that they design products and services in a way that will avoid foreseeable harm to consumers and not adversely affect retail customers in the relevant market. This may require them to proactively contact customers warning them of them of the long-term consequences of holding large cash balances. Firms which do not do this can expect further Supervision action, and possibly Enforcement referrals.

Andrew Barber considers the FCA's work on motor finance and the Bank of England's review of its core settlement system.

DISCRETIONARY COMMISSIONS IN MOTOR FINANCE

In a nutshell...

Until the FCA banned the practice in 2021, lenders providing car finance allowed car dealers to set their own interest rates on repayment plans. In some cases, this led to car dealerships setting rates above the lenders' preferred rates in order to earn larger commissions. This practice has come under intensive regulatory scrutiny in recent months.

Further detail...

In January, the FCA published a policy statement concerning changes to complaints handling rules for motor finance complaints, putting a 37-week pause on the need for firms to respond to a complaint within 8 weeks. The timeframe in which a complaint can be referred to FOS was also extended from 6 months to 15 months. The FCA intends to use Skilled Person reviews and, subject to its diagnostic work, it may set up an industry-wide redress scheme under s.404 FSMA.

The FOS has issued a number of significant decisions in this area recently where it has found that there was a conflict between the interests of consumers and brokers, and that had the customers been made aware of the commission, they may have acted differently.

Key takeaways...

Whilst the costs to the UK financial sector are unlikely to reach those of the PPI scandal, they may still be significant as car finance accounts for about 5% of household lending. While banks backed about 40% of all UK dealership car finance loans as of 2017, the rest was accounted for by non-bank lenders including the financing arms of global car manufacturers.

In terms of remediation, it is notable that Nikhil Rathi has stated it is "improbable" the FCA will find nothing to address as it looks at historic motor finance sales. It would not be surprising, therefore, to see the regulator take relatively interventionist actions in this area – particularly when set against the Consumer Duty and the need to provide good outcomes for customers.

The FOS has also put down some strong markers in terms of how it will evaluate such cases. The latest decisions are light on certain legal questions around agency and causation which may be susceptible to challenge in the courts in due course. Ultimately, the 'direction of travel' here is fairly clear: firms will need to be ready for robust FOS complaint-upheld decisions as and when complaints fall to be heard after the FCA's pause.

BOE PAYMENTS REVIEW

In a nutshell...

The impact of technology on the financial and payment landscape was recently highlighted in a speech by Victoria Cleland, Executive Director for Banking, Payments and Innovation at the Bank of England (the Bank), focusing on the Real Time Gross Settlement (RTGS) service.

Further detail...

RTGS makes available final settlement of the Bank's money. Ms Cleland's speech focused on the importance of ensuring RTGS continues to adapt to the industry. In this light, the speech touched on several key points.

The first key theme was renewing the RTGS infrastructure to provide more resilient, flexible and innovative settlement. Following the implementation of ISO 20022 in June 2023, there will be a transition to a new core settlement engine. In relation to how the benefits of ISO 20022 can be maximised, from November 2024, purpose codes and Legal Entity Identifiers (LEIs) will be mandated in specific CHAPS payments, and from November 2025, structured addresses and remittance data will be mandated. Benefits of the new core settlement engine will include enhanced reliance and capacity, ability to accept CHAPS payments up to 10 days in advance, and enhanced liquidity-saving mechanisms.

Another key theme was improving access to RTGS. Access to RTGS has been a focus for the Bank for several years. The Bank has identified the following potential areas for further development:

- understanding whether assessment processes for new Non-Bank Payment Service Providers looking to access RTGS need further adjustments to facilitate onboarding without impacting safety and soundness;
- exploring whether a new assurance regime for non-systemic Financial Market Infrastructures could make it easier for less mature infrastructure firms to benefit from settlement services without impacting the Bank's risk requirements; and
- considering whether the Bank should review the CHAPS value threshold of 2% and factors for withdrawing consent when this is exceeded by an indirect participant.

Key takeaways...

As is evident from the matters discussed in Victoria's speech, innovation and improvement of the RTGS system is a key focus for the Bank. In addition to a consultation on improving access to RTGS, the Bank is also seeking views on the benefits of enhanced availability of RTGS given that the new system will have the capability to support extended operating hours (including to near 24x7 operation). Payments and banking firms looking to influence the future outlook for access to settlements and related market infrastructures should respond to the consultations by 30 April 2024.

Venetia Jackson examines the latest data from the FOS and recent work by the Bank of England and Treasury on resolutions.

FOS TRENDS AND STRATEGY

In a nutshell...

The cost of living, motor insurance and motor finance are expected to be key themes for FOS complaints this year. The FOS is anticipating a continued increase in numbers of complaints received, with a prediction of 181,000 complaints being made in the next financial year. At the same time, the Service is targeting speedier resolution of complaints, with a target of resolving 90% of cases within 5 months. The FOS is also consulting on changes to its fees, with a reduction in its fee and levy and a potential imposition of fees on claims management companies.

Further detail...

The FOS' latest quarterly data published for Q3 2023/24 reveals an ongoing rise in the number of complaints. The top 5 most complained about products are current accounts, credit cards, hire purchase (motor), car/motorcycle insurance, and buildings insurance. Trends the FOS have highlighted include a significant increase in fraud and scam complaints in relation to current accounts, and the fact that 55% of new credit card complaints concern unaffordable lending. Over 75% of all credit card complaints made were brought by professional representatives.

Concerns of consumers include a lack of intervention by firms over persistently high credit balances and high credit limits. In the case of insurance, rises in complaints have been driven by delayed claim payouts and delayed repairs due to unavailability of contractors or materials.

Although there has been a rise in complaints taken to FOS, overall uphold rates do not show major changes, with uphold rates for the third quarter being 35% on average compared to 37% for the previous quarter.

Key takeaways...

With FOS complaints continuing to rise, firms' complaints handling processes are a vital step in mitigating an increase in complaints going to the FOS stage and so contributing to good customer outcomes.

The consumer concerns highlighted by the FOS are all issues that resonate with the FCA's Consumer Duty, in particular the consumer support outcome. Ensuring good consumer support processes throughout the lifecycle of a product can help mitigate these concerns and reduce the risk of FOS complaints.

RESOLUTION UPDATE

In a nutshell...

2023 saw the first bank resolution for over 9 years with the case of Silicon Valley Bank UK (SVBUK) and further resolution work supporting the Swiss authorities in relation to the collapse of Credit Suisse. The Bank of England has published a speech evaluating the use of its resolution tools, and implemented an update to the Purple Book. In addition, HM Treasury has consulted on changes to enhance the special resolution regime in relation to small banks.

Further detail...

In the updated Purple Book, the Bank outlines its approach to resolutions. The Bank uses three broad strategies to plan in advance for resolution: bail-in, transfer to a private sector purchaser, and using the Bank Insolvency Process. Which strategy is used will always depend on the facts of the particular situation, but for large banks, the Bank will always prefer bail-in if possible. In practice, given the uncertainties involved in a resolution situation, contingency planning for multiple resolution strategies in parallel will be required.

The Bank notes it has learned from SVBUK that even for smaller banks, there may be circumstances where stabilisation tools such as bail-in are a better option than a Bank Insolvency Process. To support this, HM Treasury has consulted on introducing a new mechanism to enable funding to be provided to support the capitalisation of a small failing bank that is not required to hold additional equity and debt. This funding would be provided through the FSCS and could be deployed in circumstances where the Bank considers a private transfer is feasible, subject to being able to facilitate the costs of this.

The Bank highlights the importance of international cooperation in facilitating larger bank resolutions, and the availability of its Resolution Liquidity Framework to quickly provide liquidity as needed in these situations. The Bank emphasises the importance of firms also being prepared, using the Resolution Assessment Framework to assess and assure themselves of their resolvability.

Key takeaways...

Overall, the Bank of England and HM Treasury consider that the resolution regime works well and has the necessary flexibility within it. It is important not to be complacent and banks must continue to assure themselves of their resolvability. If implemented, the new FSCS funding mechanism will further support successful resolution of smaller banks, although the costs of doing so will be recovered through a bank levy post-resolution.

Nicholas Kamlish considers recent regulatory work in relation to sustainability and money laundering.

ESG UPDATE

In a nutshell...

The FCA continues to maintain its focus on sustainability, with support for sustainable finance advisers and a voluntary code of conduct for Environmental, Social and Governance (ESG) ratings and data products providers, as well as plans to widen the scope of the anti-greenwashing rule.

Further detail...

The first element of the FCA's sustainability strategy is to partner with industry to help promote the UK as a world-leading, competitive centre for asset management and sustainable investment. To this end, the regulator has set up a working group to support industry in advising consumers on products making claims about sustainability. The FCA will sit as an active observer of the group and has asked that it be ready to report on how the advice sector can be supported in delivering good practice in the second half of 2024. The group will be made up of both larger and smaller advice firms, and will also engage with consumer representatives.

Alongside the establishment of the working group, the FCA has endorsed a voluntary code launched by the International Capital Market Association (ICMA) and the International Regulatory Strategy Group (IRSG). The code covers transparency, good governance, management of conflicts of interest, and strengthening systems and controls in the sector.

The other element of the FCA's strategy to integrate the Sustainability Disclosure Requirements and Investment Labels across the market, including the anti-greenwashing rule and guidance. These rules currently apply to UK asset managers. The regulator is planning to expand the regime, starting with a consultation in relation to portfolio managers in 2024.

Key takeaways...

With the announcement in the Spring Budget that the government will regulate the provision of ESG ratings, where these assessments of ESG factors are used for investment decisions and influence capital allocation, firms can expect further interventions in this area. It will be interesting to see whether the intention of providing a full consultation response and legislative steps later this year will be maintained given the impending general election. Providers of sustainable finance products and advice should continue to scrutinise all ESG-related claims, as well as engaging with relevant working groups, codes and FCA Supervision to stay 'ahead of the curve' and avoid being caught out by multi-firm reviews or investigations.

FOCUS ON FINANCIAL CRIME

In a nutshell...

The FCA has sent a Dear CEO letter to Annex I financial institutions setting out common weaknesses in financial crime controls. The regulator's focus on financial crime has been highlighted by a series of recent cases.

Further detail...

Annex 1 businesses include a range of firms, like safe custody providers, money brokers and financial leasing companies, which must be registered and supervised by the FCA for their compliance with the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs). There are also Annex I firms like serviced office providers which are regulated for compliance with the MLRs by HMRC.

The key areas of weakness picked out by the FCA include the following:

- Business Model – discrepancies between firms' registered and actual activities, and lack of financial crime controls to keep pace with business growth;

- Risk Assessment – weaknesses in Business Wide Risk Assessments and Customer Risk Assessments, with assessments either not taking place or being done on a generic basis, rather than in relation to a firm's specific risks and customers;

- Due Diligence, Ongoing Monitoring and Policies and Procedures – lack of detail in policies creating ambiguity around actions staff should take to comply with their obligations under the MLRs, with particular weaknesses on enhanced due diligence and recording suspicious activity reports.

The FCA's commitment in its Business Plan to reduce and prevent financial crime can be seen in its recent decision to charge four individuals with investment fraud and money laundering, a series of arrests with the NCA for insider dealing and money laundering, as well as enforcement of a confiscation order against a convicted money launderer.

Key takeaways...

The regulator remains determined to show that it has 'teeth' to tackle financial crime. FCA-regulated Annex I firms need to be aware that they need to maintain robust systems and controls, which are overseen by appropriately trained and experienced staff and senior management, stemming from a thorough assessment of their customers and risks. This assessment should take into account both money laundering risks and terrorist/proliferation financing. FCA-authorised firms and HMRC-regulated Annex I firms should also read the Dear CEO letter as an indication of potential areas of focus for reviews by FCA and HMRC supervision. Firms which neglect their financial crime controls can expect business restrictions, skilled person reviews and financial penalties/prosecution.

Matt Saward reviews an FCA case concerning financial promotions and changes to the Bank of England's policies.

LCF CASE UPDATE

In a nutshell...

The FCA has imposed a £31,800 financial penalty on Floris Jakobus Huisamen and issued an order prohibiting him from working in financial services. During his time at London Capital & Finance plc (LCF), which collapsed in 2019, Mr Huisamen recklessly signed off hundreds of misleading financial promotions.

Further detail...

The FCA stated that the key misconduct leading to Mr Huisamen's punishment was his involvement, since his appointment as a director from 2016, with LCF's information memoranda, brochures and the contents of LCF's website. All of these were recklessly signed off by him as compliant with the FCA's financial promotion rules despite his own concerns about the materials.

LCF, an unauthorised firm which sold mini-bonds to retail investors, sold over 16,700 bonds to 11,625 customers between 2013 and 2018.

The FCA explained that while LCF had internal processes for confirming the financial promotions' compliance, Mr Huisamen failed to follow these on numerous occasions.

The processes included completing a verification schedule listing all the statements to verify, which had to be signed off by the senior management and Mr Huisamen, as well as a financial promotions checklist confirming that the materials complied with COBS financial promotion rules. On numerous occasions, neither the schedule nor the checklist was filled out, and according to the FCA, "*the approval process became nothing more than an ineffective tick-box exercise*".

Despite having knowledge of the business' concerning practices around asset ownership and his subsequent concern that the promotional materials were not FCA compliant, Mr Huisamen continued to sign off financial promotions.

In addition to issuing a financial penalty, the FCA deemed Mr Huisamen to lack the fitness and propriety to perform a function within any financial services firm carrying out regulated activities.

Key takeaways...

This decision by the FCA highlights the regulator's strict approach when punishing officers and directors for their failures to ensure compliance with the financial promotion rules. The FCA also makes it clear that it is not enough for firms to have internal processes, but instead, firms need to ensure the processes are being carefully followed each and every time, instead of merely completing a 'box-ticking exercise'.

BOE UPDATE ON ITS NEW PROCESSES AND POWERS

In a nutshell...

With the commencement of the Financial Services and Markets Act 2023, the Bank of England was given a range of new powers and responsibilities. In order to use them, the Bank published PS1/24, a policy statement on its updated enforcement policies, and issued a consultation paper on its approach to statutory notice decisions for use of its requirements powers.

Further detail...

The new powers allow the Bank to make rules in respect of central counterparties (CCPs) and central securities depositories (CSDs) in pursuit of its statutory objectives. The act also imposes new responsibilities on the Bank, such as facilitation of innovation, carrying out of cost benefit analyses, as well as introducing new accountability mechanisms. Furthermore, the Bank was given requirements in respect of transparency in its decision-making. As a result, it has launched a consultation on the allocation of decision-making regarding statutory notices, its approach to supervisory statutory notice decision-making, and its approach to publication of supervisory statutory notice decisions. The consultation closed on 21 March 2024.

The Bank's revised approach to enforcement includes a number of updated procedures, such as the creation of a consolidated Bank Enforcement Approach. The Bank has also introduced a new option for early cooperation called the "Early Account Scheme" (EAS), supported by a new Enhanced Settlement Discount of up to 50%, although the Bank has made it clear that these options will not be available where criminal conduct is suspected. Other changes include the revision of the PRA's policies on the imposition and amounts of financial penalties for firms and individuals. While the changes came into force on 30 January 2024, the old penalty and restriction regime will still apply to breaches committed before that date.

Key takeaways...

The Bank's consultation on statutory notice decisions brings transparency to how its new powers will be exercised and invites the affected firms to have their say in how the new policy is shaped. In particular, firms should note that the consultation would introduce safeguards in relation to the Bank's supervisory powers which are similar to those in place for the PRA and FCA, such as the ability to make representations and references to the Upper Tribunal.

The Bank's updated approach to enforcement will introduce useful changes, such as the introduction of the EAS and greater settlement discounts. It remains to be seen if similar changes will be implemented by the FCA in the future.

Finally, Anthony Harrison explores the FCA's approach to market abuse and the FSCS' priorities.

MARKET ABUSE UPDATE

In a nutshell...

In its recently published Business Plan for 2024-2025, the FCA has emphasised that it will be increasing its capability significantly to tackle market abuse.

Further detail...

The FCA plan highlights a number of initiatives that are either underway or due to be commenced which demonstrate a continued intent to take on market abuse proactively. These include:

- increasing its ability to detect and pursue cross-asset class market abuse. The FCA has indicated that it will build on its analytics capabilities such as network analysis and cross-asset class visualisations;
- developing improved market monitoring and intervention in relation to fixed income and commodities, covering both market abuse and market integrity;
- issuing a discussion paper on transferring the MiFID data reporting regimes for transactions, and reference data, as well as assisting in delivering a proportionate market abuse regime for cryptoassets and the PISCES facility;
- extending its data reporting supervision approach to European Market Infrastructure Regulation (EMIR), Securities Financing Transactions Regulation (SFTR) and Orderbook regimes. It will increase resources and capability to influence international markets data strategy;
- publishing the results of our peer review of market abuse systems and controls in providers of Direct Market Access; and
- publishing revised Market Cleanliness Data in Q3 2024, which will capture more anomalous trading compared to existing metrics.

Key takeaways...

The Plan looks to build on a significant amount of work that has already been started in this area, as part of the FCA's three-year strategic cycle. At the heart of this work is a commitment to technological improvement and enhanced data analysis consistent with the regulator's broader intention of being a data-led regulator. Against that backdrop, relevant companies and regulated firms will also want to keep a close eye on their own technological capabilities, systems and controls and quality of data to ensure they, too, are sufficiently up to speed when it comes to mitigating against market abusive practices which continue to evolve at a rapid rate.

The FCA's initiatives underscore a broader reform agenda when it comes to wholesale markets as it looks to oversee market abuse regimes in relation to developing areas such as cryptoassets and PISCES. Striking the balance between innovation and investment on the hand, whilst ensuring market integrity and confidence on the other, will continue to be a fine one.

FSCS TRENDS AND STRATEGY

In a nutshell...

The FSCS have set out their reflections on 2023 and their strategic outlook, highlighting their yearly claims figures, key improvements to their processes including the introduction of a three-month appeals time limit, and predictions about the future of cryptoassets.

Further detail...

The FSCS made 40,197 claim decisions and found 21 firms in default throughout the course of 2023, paying out millions in compensation – largely facilitated by their expanded in-house team of experts. This, in part, led to their highest ever customer satisfaction score (90) being achieved.

The FSCS have also reinforced the message that they will exercise maximum effort in ensuring all customers of firms that go out of business are made aware of compensation they may be due. This was exemplified by their handling of the recent Hastings & Rother Credit Union failure, whereby representatives of FSCS appeared on the radio encouraging potential claimants to seek compensation and explaining the process.

Some of the Service's new solutions to streamline their processes and increase accessibility include the following.

- A new platform has been designed for processing insurance claims, which make up 40% of the compensation paid by the FSCS each year.
- From 21 February 2024, a new policy has applied which contains a time limit on appeals of three months; this is intended to increase FSCS efficiency in resolving claims.
- The FSCS has also developed a platform for making electronic payments to customers in the event of a bank or building society insolvency.

In terms of commentary by the FSCS, the Service's Chief Data, Intelligence and Technology Officer (Sabah Carter) recently provided her view that, in the wake of the collapse of FTX, the crypto bubble is very much still intact and regulation/education in relation to the cryptoasset sector must be improved.

Key takeaways...

The FSCS is committed to continued growth and support for its users, exemplified by its claims figures for 2023, and investment in processes and policies that are designed to make the claims process more efficient. Firms should note the new appeals time limit when developing resolution plans. Firms should also read the commentary sections of the FSCS website, which contain helpful guidance on scam typologies (for firms developing anti-fraud systems and controls) as well as analysis on gender disparities in customer understanding (for firms considering their customers' characteristics and vulnerabilities under the Consumer Duty).

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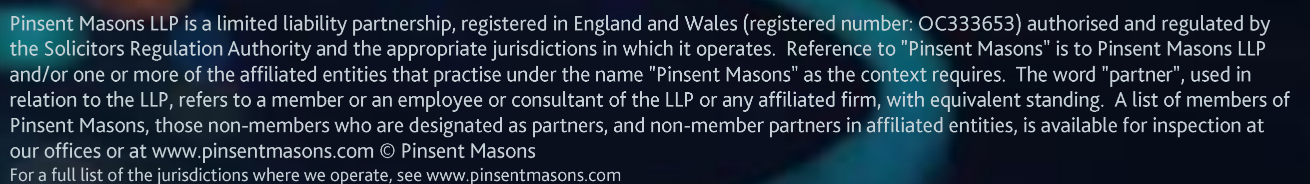

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