Sanctions and credible deterrence

In this month’s briefing, we discuss the sanctions the FCA has at its disposal. We take a look at:
- sanctions available to the Regulator;
- recent trends in this area; and
- what the future might hold.

Sanctions

In order to punish misconduct and deter similar conduct in the future, the Regulator is able to bring enforcement cases and levy tough penalties for infringements of rules, pursue cases against individuals, hold members of senior management to account and pursue criminal prosecutions.

Two sources of rules and guidance are relevant: the Decision Procedure and Penalties (“DEPP”) Manual; and the Enforcement Guide (“EG”).

The DEPP Manual includes:
(a) a description of the procedures the FCA follows in deciding whether to bring enforcement proceedings and whether to issue statutory notices such as decision notices in these proceedings;
(b) the policy with respect to the imposition and amount of penalties under the Act; and
(c) the policy relating to the imposition of suspensions of permissions or restrictions on the carrying on of a regulated activity by an authorised person or the performance of a function by an approved person (and the length of those suspensions and restrictions).

The Enforcement Guide includes:
(a) descriptions of the FCA’s approach when exercising its main enforcement powers;
(b) an overview of policy and processes in the exercise of investigatory and information-gathering powers, settlement and publicity; and
(c) an explanation of the FCA’s policy concerning specific enforcement powers including variation of firms’ permissions and the making of prohibition orders against individuals.

As summarised in Financial Services Series #2, the FCA can fine, privately warn or publicly censure firms or individuals; suspend or restrict the permission of an authorised person or the approval of an Approved Person to undertake regulated activities/functions; and ultimately withdraw or restrict firms’ authorisations and prohibit individuals from working in financial services.

The subject of any enforcement action has the option to reach an early settlement with the FCA. To promote early settlement, the subject of the enforcement action will benefit from a graduated discount in the amount of any financial penalty, or the length of any period of suspension or restriction and other conditions which the FCA seeks to impose by way of such action. The level of discount ranges from 10% to 30% depending on when in the enforcement process settlement takes place. In effect, early settlement saves all parties to the action money and time. What trends are visible in the use of sanctions under the new regime?

Trends in FCA sanctions

In its Enforcement Annual Performance Account 2012/13, the FSA stated:

The FSA’s approach has been to achieve credible deterrence regarding our Financial Services and Markets Act (FSMA) mandate. We have focussed on cases where we think we can make a real difference to consumers and markets, using enforcement strategically as a tool to change behaviour in the financial services industry. We have a range of sanctions available - criminal, civil and administrative - and we will use these sanctions to deliver strong, visible enforcement outcomes.

With this aim in mind the FSA published 79 Final Notices in 2012/13; conducted four trials resulting in 13 criminal convictions and 43 prohibitions. 76 investigations were closed with 39 of these concluded by some form of executive settlement.

The new-look FCA is seeking to build upon the work of the FSA in creating “credible deterrence”. 
Fines that “hurt”

The increase in levels of fines which was already apparent under the FSA has continued under the FCA. The Regulator has continued to fine regulated firms and individuals at levels and in ways which aim to create a deterrent effect.

- figures published in the final quarter of 2013 indicate that the Regulator's fines for 2013 were (at that stage) at £446 million, compared to £331 million in 2012 and £66.1 million in 2011.
- the majority of these fines relate to PPI redress, LIBOR-rigging and market abuse showing that the FCA continues the work started by the FSA whilst also addressing any new issues that arise under its jurisdiction.
- since the publication of the above figures, the FCA has also imposed a record bank fine.
- amounts of fines are increasing under the new penalty calculation regime in DEPP 6. The £900,200 fine of SEI Investments (Europe) Limited (“SEI”) is an illustration of the changing regime. SEI was found to have had failings in its client money reconciliations during a period which straddled the introduction of the new regime. SEI's fine was calculated partly under the new regime (fine equal to 2% of the average amount of client money held during the period) making it higher than it would have been if it had fallen only under the old (fine equal to 1% of the average amount of client money held during the period).

Individuals and senior managers

The FCA is also building on the FSA's work in imposing significant fines on individuals.

- Individual fines have been on the increase over recent years: after a sharp (over 45%) rise between 2010 and 2011, individual fines in 2012 were at a similar level.
- 2013 has seen very significant fines against individuals, including Chadda (£945,000) and Coscia (£600,000).

Transparency and publicity

The FCA uses transparency and publicity to drive home the impact of its regulatory penalties and interventions, including earlier interventions.

- it has new powers to make public statements on the issue of Warning Notices. A practical effect of this power will almost certainly be to increase the pressure on firms to reach an early settlement once they have seen the Enforcement case against them but before proceedings have formally been issued.
- the FCA now has the power to publish misleading financial promotions on its website together with a direction to ban the promotion if that is what it decides to do. This power has not yet been exercised but can be used independently of any enforcement proceedings.
- the Regulator has said that it is seeking to intervene earlier when it identifies misconduct. Regulated firms should expect to see greater cooperation between Supervisors and the Enforcement team to co-ordinate their investigations before any formal enforcement action is taken by the FCA.
- private warnings are used in certain circumstances by the FCA where misconduct is less serious. For obvious reasons, they do not have the same deterrent effect as a public censure. Recently, we have seen an example of the Regulator going beyond its previous practice in the use of public censures to increase deterrent effect. The Upper Tribunal has upheld the FSA's £100,000 fine of Westwood Independent Financial Planners (“Westwood”) for regulatory breaches in the sale of geared traded endowment policies (“GTEPs”). Westwood was in liquidation (or the Scottish equivalent). In the past, firms in liquidation which had breached rules in relation to GTEPs were penalised by way of public censure. In the present matter, the Tribunal agreed with the FSA's decision that it was appropriate to impose a fine in order to reinforce the credible deterrent to others.

Practical points

The FCA has some new powers. However, in the main, it is simply focussing on building on the work of the FSA to achieve credible deterrence and hold senior management to account. The publicity, transparency and move towards early intervention mean that, in some ways, it is more important than ever to create a meaningful dialogue with Supervisors (if this is possible) and Investigators. Early engagement and, in appropriate cases, settlement can bring sizeable discounts to any eventual penalties.

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<td>Published 9 December 2013</td>
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