RPC

The FCA: key themes for 2017/2018

At the half way point in the Financial Conduct Authority's (FCA's) financial year 2017/2018, it is an opportune moment to look back at the key developments that have taken place and consider the likely areas of activity in the second half of the year.

We consider the FCA's recent enforcement activity as well as developments in some of the priority areas identified in the FCA's Business Plan for 2017/2018, including:

- firms' culture and governance
- financial crime, in particular Anti-Money Laundering (AML)
- technological change and resilience.

Executive summary

The FCA continues to advance the priorities laid out in its latest Business Plan. AML, and Governance and Conduct are key areas of development so far in relation to the FCA's regulatory framework. We expect more Enforcement outcomes from the FCA in the second half of the year for the troubled sectors of pension transfers and contracts for difference (CFD) platforms, as well as, continued AML Enforcement actions across the spectrum of financial services firms.

FCA enforcement

The FCA made seismic changes to its Enforcement Process that came into effect in early March 2017. (For more information see our Article on the topic.) One of the most significant changes allows parties, for the first time, to dispute the financial penalties that the FCA seeks to impose on them without losing the potential 30% discount on the penalty. We anticipate this increased flexibility in the Enforcement process will result in more cases being referred to the Regulatory Decisions Committee.

However, we do not anticipate a return to the bumper levels of fines that flowed from the LIBOR and FX investigations in previous years. In the last two years, we have seen the total fines imposed by the FCA drop from approximately £900m in 2015 to just £22m in 2016. Apart from the significant fine imposed on Deutsche Bank of £163m at the start of 2017 (discussed below), we anticipate that fines will remain relatively moderate for the rest of 2017 and into 2018, but the impact of FCA Enforcement action is significant regardless of the level of financial penalty. Just ask anyone interviewed by the FCA.

So far, the FCA has issued only a handful of Final Notices this financial year, focussing predominantly on market abuse offences for individuals (and one for a compliance officer of a pension advisory firm). We expect further Enforcement outcomes in the next 6 to 12 months, in particular for AML failings as well as outcomes in the pensions advisory and the CFD sectors.

Any comments or queries?

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In relation to the pensions sector, the FCA issued an alert in January 2017 regarding its concerns as to the suitability of the advice that is being given to pension holders. Following this announcement, numerous firms have been required to suspend their Defined Benefit transfer business; with possible FCA enquiries following.

The CFD sector is similarly facing ongoing scrutiny, following the concerns raised in the FCA's Dear CEO Letter in February 2016 and a consultation paper in December 2016 (CP16/40) as to the risks to retail investor protections posed by these complex financial instruments. CP16/40 sets out various proposed changes to the conduct rules for CFD firms, including enhanced disclosure requirements and leverage limits.

We expect Enforcement action to follow for firms offering CFD products given that the FCA's concerns relate to losses suffered by the most vulnerable category of investors and CP16/40 refers to "increasing evidence of poor conduct" by these firms.

The CFD industry is similarly coming under increasing pressure with the European Union authorities in relation to the risks its poses to retail investors. The European Securities and Markets Authority (ESMA) has announced its intention to use its product intervention powers (which it is soon to acquire under MiFID II) to restrict CFD activity across the EU in 2018. (For more information, see our Article on the topic.) The FCA announced in June 2017 that it will delay finalising changes to the conduct rules for the CFD sector at a domestic level until after ESMA takes action in 2018.

Overall, the outlook for the CFD sector has never seemed more uncertain – firms will likely be dealing with penalties for historic practices while having to adjust to a new and much less friendly regulatory landscape next year.

FCA priority: culture and governance

The FCA continues to prioritise bringing changes to the culture and governance of financial services firms through increasing levels of individual accountability.

The FCA has already issued several final notices to individuals since the start of the financial year, demonstrating its commitment to holding individuals to account. The FCA is also pushing forward with its plan to expand the Senior Managers and Certification Regime (the SM&CR) to all financial services firms (which currently applies predominantly just to banks and building societies).

The FCA issued a consultation paper on the SM&CR in July 2017[1], seeking views on the proposed changes, noting it intends for the regime to be "proportionate and flexible" when rolled out to all firms in order to take into account the variety of business types that will be affected.

The aim is for the SM&CR to replace the Approved Persons Regime after the final rules are published by the FCA in 2018. This will represent a significant change for many firms, which will also still be in the process of adjusting to the requirements of MiFID II, which comes into force on 3 January 2018.

FCA priority: financial crime and anti-money laundering

The FCA's continued efforts to make the UK a hostile environment for financial crime show no sign of abating. Financial crime and AML is proving to be an area of significant focus this year.

In addition to the latest Money Laundering Regulations coming into force on 26 June 2017, the FCA also issued finalised guidance on the treatment of Politically Exposed Persons for AML practices in July 2017[2] and it has opened a guidance consultation in relation to the preparation of

1. (CP17/25)
2. (FG17/6)

a sourcebook for the new FCA supervisory body that will oversee other anti-money laundering supervisory bodies in the UK (such as the Institute of Chartered Accountants for England and Wales)[3].

In relation to Enforcement, no public outcomes have been announced by the FCA for AML failings for any firms since the final notice issued to Deutsche Bank in January 2017, which included a record breaking financial penalty for AML failings of £163m. However, we anticipate that further action will be taken by the FCA against firms for AML failings before the end of the financial year given that it has been an overwhelming focal point for the FCA for the last 18 months.

In addition, the FCA has signalled in its latest Business Plan that it intends to depart from its more usual practice of imposing financial penalties and prohibitions on firms and individuals for AML failings, by using its Enforcement powers to impose business restrictions on firms to mitigate the risk of money laundering where necessary. The FCA exercised these powers in relation to Sonali Bank in 2016, prohibiting the bank from taking on new deposit accounts for 168 days in addition to a financial penalty for AML failings.

FCA priority: technological change and resilience

The FCA has placed technology at the core of its priorities for this financial year, focussing on ways to foster technological innovation at financial services firms, whilst seeking to curtail the ever-increasing risk of cybercrime.

At the start of the financial year, the FCA highlighted in its Business Plan the increasingly valuable role fintech firms have to play in the financial services industry, noting their potential to move firms towards "less capital intensive business models" as a result of technical innovations which could reduce firms' ongoing costs.

In particular, the FCA has focussed on the role that technological innovation has to play in relation to AML and financial crime prevention. The FCA published a report in August 2017 which it had commissioned to obtain views from financial services firms and technology providers on the use of emerging technologies for the prevention of money laundering.

The report shows that the main areas of AML for which new technologies were considered related to customer due diligence checks, anti-impersonation checks and transaction monitoring for suspicious activities. Firms were most interested in the use of data analytics, machine learning and natural language processing as ways of delivering significant cost reductions and enhancing the prevention of fraud and money laundering.

The FCA is keen for firms to engage in new technological processes in relation to AML procedures to cut costs and improve detection of financial crime issues. However, firms remain concerned as to how lenient the FCA will be if firms encounter AML failings due to teething problems with new technological advances. It may be that the regulatory sandbox will provide the answer, by allowing firms space to test new technologies in the first instance before rolling them out across their businesses. It remains to be seen what appetite firms have to take the next steps in this regard.

3. (GCP17/7)

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