



FSA enforcement in 2010

In this briefing we consider, in light of the Financial Services Authority's enforcement activity in 2009, what the main themes are likely to be for regulatory enforcement in the coming year.

Enforcement activity in 2009

The Financial Services Authority (FSA) has for the past few years been signalling a tougher approach to enforcement, through its ambitious agenda of creating a 'credible deterrent' to misconduct. It has also been using a wider variety of its enforcement powers. Although it is much too early to judge whether the FSA will be successful in creating credible deterrence, we are at least seeing results that are consistent with its activities.

The table on the next page summarises the outcome of the FSA's enforcement activity in recent years. It shows that 2008-09 represented a step-change in activity across the board, including fines, prohibitions and the use of gatekeeper powers. The FSA imposed a record level of fines, and a record number of prohibitions, and it succeeded in its first criminal prosecution for insider dealing.

The running total of fines for the current year (2009-10) already exceeds the total for 2008-09: fines stood at about £29m after just eight months. So, we could see total fines of over £40m this financial year. Another notable feature is the increased number of actions against individuals, with over 45 prohibitions so far.

In the past (for example, 2004-05), high total fines tended to reflect a very significant penalty in just one or two significant cases. In contrast, the figure for 2008-09 reflects multiple fines in excess of £1m and several fines of £5m or more.

Enforcement themes for the future

Looking ahead, the general direction of travel of enforcement policy is at the moment clearer than it has been for some time. The FSA has invested very significant resources in its Treating Customers Fairly initiative in the retail markets, in pursuing market abuse and insider dealing in the wholesale markets, and in dealing with financial crime. Many of its enforcement cases have been in these areas and these are likely to remain the main focus from an enforcement perspective.

With many consumers stretched, we expect the FSA to continue to place a great deal of emphasis on enforcement in the retail market. It has emphasised the importance of firms continuing to focus on treating customers fairly in this economic environment. It has conducted thematic reviews of practices in the mortgage market and of sales of structured products to retail investors. GMAC was fined £2.8m for failing to treat fairly mortgage customers in financial difficulty, but beyond this we have yet to see this work resulting in significant, published enforcement activity.

Financial crime has been very much in the public eye – and is likely to continue to be a focus. The FSA is not – and says it does not intend to become – a general prosecutor, so it will not generally prosecute fraud and other, general offences. However, it has emphasised the importance of its supervisory work on crime prevention, as well as taking enforcement action where it finds inadequate systems to prevent criminal activity, such as data theft, money laundering and fraud.

FSA enforcement activity

Reporting year (1 April to 31 March)	No. of fines	Total of fines (£m)	Public censure only	Criminal outcome	Prohibition	Final notices against individuals
2002-03	15	9.17	2	1	4	
2003-04	22	12.38	3	1	9	
2004-05	31	22.25	0	0	9	19
2005-06	17	17.43	2	3	7	26
2006-07	32	14.66	4	1	10	20
2007-08	21	4.45	2	0	30	63
2008-09	55	27.34	10	1	58	106

The FSA has succeeded in its first two prosecutions for insider dealing and a number of other prosecutions are in the pipeline. Its work on market abuse and insider dealing (as well as systems and controls issues in appropriate cases) is likely to remain a focus for wholesale enforcement.

The FSA's more direct and intrusive approach to supervision is likely to affect its approach to enforcement. Its new approach means it will now question a business's judgements rather than waiting to pick up the pieces if something goes wrong. It anticipates that its focus will be less on systems and controls and more on management capability and testing business judgements.

We are already seeing a more direct approach being taken in an enforcement context – for example, the FSA prefers to test 'outcomes' than to spend time investigating systems. However, this can create difficulties. There can be a temptation to view the 'outcomes' as answering the question of whether a regulatory breach has been committed. But the FSA rules do not require firms to guarantee outcomes; on the whole, they require firms to take reasonable care to achieve them. There is an obvious danger in rushing to a conclusion that a poor outcome demonstrates that the rules have been breached.

A more direct approach may, curiously, lead to fewer enforcement actions in some areas. Enforcement can be a cumbersome and resource-intensive process and the FSA is increasingly creative in finding quicker ways of achieving its objectives.

Individuals in management positions are also likely to remain a focus for enforcement. For some years, the

FSA has talked about the need to hold management personally responsible if their omissions lead to regulatory breaches. It is not straightforward to take action against individuals for (alleged) omissions – and the FSA has rarely achieved this. But this has been a particular area of focus for the past year or so and we may well start to see significant cases in due course.

Other regulatory developments

Other potential developments are likely to have an effect on enforcement this year.

First, the FSA is due to provide its feedback statement this month on its proposed new policy on setting enforcement fines. It is unclear precisely how the new fining framework (which is based on percentages of revenue or (for individuals) income) will operate in practice, but it will certainly mark a very significant change in fining policy and is likely to lead to greatly increased fines. The FSA estimates that fines will double or treble compared with current levels. On one view, some fines could be much higher than that.

Second, the Financial Services Bill is making its way through parliament and may well be passed before the general election. It gives the FSA additional enforcement powers, including a power to suspend or restrict a firm's activities for up to 12 months as a disciplinary matter (and a similar power for individuals). This is common in other jurisdictions but would be new in the UK. At present, there is no information about how the FSA would use it.

Third, the Financial Services Bill could usher in a new era for handling mass consumer claims. This is an area that

has long been ripe for reform – because the system was designed for individual claims but has increasingly been used for mass claims. The proposals in the Bill would mark a radical change. The Bill would allow a collective action to be brought by a representative on behalf of a class of consumers. Importantly, it would also give the FSA a new power to impose consumer redress schemes on the industry. Such schemes could cover liability not only for regulatory breaches but arising from any legal duty. There would be a new role for the Financial Ombudsman Service. In effect, the FSA could establish, by making rules, the liability of a firm to its customers. If introduced in this form, this novel power would present a significant challenge for firms.

Finally, it would be wrong to ignore the general election this year and the uncertainty that that creates over the structure of financial regulation. What effect, if any, this will have on regulatory enforcement is unclear – and will remain to be seen.

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