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Insights

RESPONSE TO FCA'S CP24/2

BCLP SUBMITS RESPONSE TO FCA'S CP24/2 ON CONTROVERSIAL PLANS TO ANNOUNCE ENFORCEMENT INVESTIGATIONS

Apr 29, 2024

EXECUTIVE SUMMARY

We strongly disagree with the FCA's proposals, set out in CP24/2, to announce that it has opened enforcement investigations into firms where it considers this to be in the public interest. We set out our objections in detail below, which collectively constitute our response to questions 1 to 6 in CP24/2. These views are also informed by the roundtable discussion that took place at our offices on 27 March 2024 between Therese Chambers, BCLP representatives and various representatives of our clients (the "**Roundtable Discussion**").

In summary:

a. We consider that the FCA's proposals are not compatible with a number of legal obligations that apply to it, including:
   i. its general duties under section 1B FSMA;
   ii. the restrictions imposed on it under sections 207 and 208 FSMA in relation to announcing a "public censure" of firms;
   iii. its confidentiality obligations pursuant to section 348 FSMA; and
   iv. firms' and individuals' right to privacy pursuant to Article 8 of the European Convention on Human Rights.

b. Moreover, we also consider that the proposals give rise to a number of significant practical issues, including:
   i. a likely material deterioration of the collaborative relationship between the FCA and the firms that it regulates, with that relationship becoming more adversarial;
   ii. the risk of serious implications for individuals, whose conduct and reputation may be subject to speculation following an announcement in relation to a firm;

iii. increased levels of mass litigation against firms, also impacting on the FCA's ability to ensure that it leads the way in getting redress to consumers.

c. We do, nonetheless, recognise and appreciate the FCA's desire to achieve greater transparency. With that in mind, if the FCA intends to take action here, we consider that its proposals should, at the very least, be modified in one of the following ways:

i. the FCA's announcement that it is opening an investigation should be anonymised, not naming the firm being investigated; or

ii. if the FCA is intent on seeking to name firms in announcements of investigations, it should:

1. broaden the factors that it takes into account in deciding whether to make these announcements to expressly include considering the impact on both firms and any identifiable third parties.

2. provide a credible and fair mechanism for firms and any identifiable third parties to make representations prior to the FCA publishing any initial announcement (we would support an amendment to the FCA's proposals to adopt a process similar to that used by the RDC in respect of Warning Notice statements).

LEGALITY OF THE FCA'S PROPOSALS

SECTION 1B FSMA: GENERAL DUTIES

The FCA is required to discharge its functions in a way that advances one or more of its operational objectives. In this regard, CP24/2 asserts that the FCA's proposals will assist in supporting the following objectives:

a. protecting customers from bad conduct – the FCA's position appears to be that the early publicity of investigations will decrease the likelihood of consumer harm through its educational and deterrence effects;

b. protecting the integrity of the UK financial system – the FCA believes its proposals will achieve this by increasing public confidence that it is acting effectively to address risks to consumers and investors; and

c. facilitating the international competitiveness and growth of the UK economy (a secondary objective) – the FCA believes that its proposals will promote trust in UK financial markets.

In respect of the latter two objectives above, our view is that, far from advancing these objectives, the net effect of the FCA's proposals to publicise investigations into firms will be to detract from those objectives.

The crux of the issue with the proposals is that the FCA's proposed public interest test appears to be almost entirely one-sided, with paragraph 3.8 of CP24/2 expressly stating that firms' interests have

been deliberately excluded as a "specified factor" in the test. Whilst we welcome Therese Chambers' clarification at the Roundtable Discussion that firms' interests will still be considered as part of the wider "facts and circumstances" of the matter, we are still concerned that those interests will play a secondary role in the FCA's decision to make any announcement. The one-sidedness of the public interest test is then further compounded by the FCA's proposal to give firms no more than one business day's notice of its decision to announce an investigation, providing them with almost no opportunity to challenge that decision.

The potential for firms being investigated to suffer significant prejudice as a result of the FCA's proposals, not least reputational damage, therefore seems obvious. We do, for the avoidance of doubt, acknowledge the FCA's proposals to make clear in its announcements that it has not reached any conclusions on firms' conduct, but we do not consider that this disclaimer will do much to mitigate the prejudice caused – when a major regulator announces that there are circumstances suggesting a firm has breached regulatory standards, customers and investors will always be inclined to believe that there is "no smoke without fire" and, among other things, reputational damage will be caused. Moreover, the prejudice caused to firms will, in many cases, likely have been unjustified and entirely avoidable in circumstances where the FCA currently closes 65% of its enforcement cases without further action. As the FSA itself stated in 1998 in Consultation Paper 17:

"Publication of the fact that an investigation has been commenced by the FSA may prompt unwarranted public concern about the matters and persons within the scope of an investigation. It may put customers' funds at risk or do unwarranted damage to the reputation of firms, issuers or individuals involved."

In light of the above, we have serious concerns that the overall impact of the FCA's proposals will be to have a detrimental effect on the orderly operation of the UK financial system and UK financial markets, rather than furthering the FCA's objective of protecting their integrity. Where firms hold client assets or investments, there is a real risk that the announcement of an FCA investigation into those firms could lead to clients withdrawing funds. In respect of smaller and mid-sized firms in particular, this could well lead to a "run on the bank" scenario and the possible failure of those firms, even if they are ultimately not found to have committed any misconduct. In respect of larger publicly traded firms, the announcement of an FCA investigation risks causing disruption to their share price and loss to their investors (many of whom will ultimately, via their pension funds or other investment assets, be the very consumers that the FCA is seeking to protect).[1]

As to the FCA's secondary objective of improving the competitiveness and growth of the UK economy, this is also likely to be detracted from by exposing firms to arbitrary announcements of investigations by the FCA, in relation to which their interests are not properly taken into account, they are provided with almost no notice and they are likely to suffer significant prejudice. In our view, this would make the UK a materially less attractive jurisdiction for firms to conduct business in. In particular, we note that financial services regulators in most other major jurisdictions do not adopt the FCA's proposed approach, which would make the UK an outlier.

We, of course, acknowledge that the FCA's proposals do go some way towards advancing its consumer protection objective. However:

a. the position here is not necessarily as clear-cut as the FCA suggests. For example, where multiple firms are suspected to have been involved in misconduct, the announcement by the FCA that it has commenced an investigation into one of those firms may be misleading to consumers in circumstances where it later intends to commence investigations into other firms. In addition, there is a risk that the announcement by the FCA of its investigation into a firm for a particular product/service could, where other firms do not have detailed information regarding the issues the FCA is concerned about, lead to those firms withdrawing similar products/services out of an abundance of caution in circumstances where it was not necessary for them to do so. The consequence of this would be an unnecessary reduction in consumer choice; and

b. most importantly, the FCA, in discharging its regulatory functions, must have regard to the regulatory principle in section 3B FSMA, which provides that any burdens placed on firms should be proportionate to the benefits that are expected to result from them. In our view, the FCA's proposals are disproportionate. This is primarily because its objective of protecting consumers through early transparency of its investigatory activities can likely be achieved by other means without causing the same degree of prejudice to firms. In particular, it seems to us that the FCA could achieve its intended consumer protection benefits in the vast majority of cases by simply publishing a sufficiently clear summary of the specific misconduct being investigated on an anonymised basis (this could even be done, for example, via Market Watch rather than via a separate press release). Naming a firm will not, in most cases, enhance the educational impact that the FCA wishes to achieve.

For the above reasons, we do not therefore consider that the FCA's proposals are compatible with its duties under s.1B FSMA.

SECTIONS 207 AND 208 FSMA: RESTRICTIONS ON PUBLIC CENSURE

Sections 207 and 208 FSMA set out a detailed process that the FCA is required to follow before it can issue a "public censure" in relation to a firm, including the issuance of warning and then decision notices. The FCA does not seem to consider that its proposed early announcements of investigations will amount to a "public censure" of firms, but this term is not defined in FSMA and the FCA does not provide any analysis to support its position. In our view, there is a real risk that the format of early announcement proposed by the FCA will in effect amount to a "public censure" of firms within the natural meaning of that term (as stated above, we do not consider that the FCA's proposal to make clear that it has not reached any conclusions does much to help). That being the case, the FCA's proposals would seem to cut across the intentions of Parliament in the detailed regime set out by sections 207 and 208 FSMA.

Indeed, in Discussion Paper 08/3, the FSA itself summarised the purpose of these very provisions as follows:

"In short, significant procedural safeguards were specifically built into FSMA in order to prevent the casual, rash or unchallenged use by the regulator of public statements that could damage a financial services firm's reputation and commercial standing. This in turn reflected the lengthy discussion and debate in Parliament during the drafting and passage of FSMA on the balance between the regulator's enforcement and other powers and the rights of the regulated…It follows that calls by some for us to 'name and shame' firms as a matter of course is not the approach envisioned by Parliament and is not one we can readily meet under FSMA"

It is concerning that, a number of years after this statement was made, the 'naming and shaming' of firms now appears to be precisely what is being contemplated, putting the effectiveness of the procedural safeguards in sections 207 and 208 FSMA in jeopardy.

SECTION 348 FSMA: CONFIDENTIALITY OBLIGATIONS

Section 348 FSMA restricts the FCA's ability to disclose "confidential information". This is information which:

a. is not already lawfully publicly obtainable;

b. relates to the business or affairs of any person; and

c. is received by the FCA for the purposes of discharging its functions.

In circumstances where the FCA's proposal is to provide in its announcements the name of the firm together with "a summary of the suspected breach, failing or other misconduct", it seems likely that many of these announcements will involve the disclosure of confidential information that is protected by s.348 FSMA. In the absence of consent to disclosure of this information by the firm to whom it relates, the FCA can only disclose this information pursuant to one of the permitted 'gateways' set out in the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001.

One gateway that may be available to the FCA in seeking to make the announcements proposed is the so-called "self-help" gateway that is set out at Regulation 3. This permits disclosure by the FCA of confidential information "for the purpose of enabling or assisting" the FCA to discharge any of its "public functions". However, we remind the FCA that those public functions must be discharged in accordance with the FCA's obligations under s.1B FSMA and, as set out above, we do not consider that the FCA's proposals are compatible with those obligations.

ARTICLE 8 OF THE ECHR: RIGHT TO PRIVACY

In addition to its obligations under FSMA, the FCA also needs to take into account its obligations to protect rights to privacy under Article 8 of the ECHR. Indeed, in DP08/3 the FSA has previously acknowledged that, "the constraints imposed on us in relation to publishing confidential information also prevent a breach of Article 8 of the European Convention on Human Rights." Our view is that the FCA's proposals are not compatible with Article 8.

The Supreme Court's decision in Bloomberg LP v ZXC [2022] UKSC 5 is instructive in relation to this point. Here the Court, applying Article 8 in the context of a misuse of private information claim, confirmed that an individual who is the subject of a criminal investigation will, in general, have a reasonable expectation of privacy in respect of the investigation until he or she is charged. Whilst the case clearly deals with a different factual matrix, there are obvious read-across implications for firms subject to FCA investigations. Like the relevant individual in Bloomberg, firms (as discussed above) face significant reputational damage once it becomes known that the FCA is investigating their conduct. It must, therefore, be right to conclude that they too generally have a legitimate expectation of privacy until a proper process has been followed to investigate their conduct and conclude that it is appropriate for regulatory action to be taken against them. As the FSA seemingly acknowledged in DP08/3, that is precisely the legitimate expectation that sections 207, 208 and 348 of FSMA are there to protect.

In addition, we also refer to our comments below about the potential for FCA announcements of investigations into firms to lead to speculation about the conduct of individuals. As a result, it seems to us that there is also a real risk of infringement of individuals' Article 8 rights, as well as the Article 8 rights of firms.

PRACTICAL CONSIDERATIONS

In addition to our serious concerns about the legality of the FCA's proposals, we also consider that they give rise to some significant practical issues.

A DETERIORATION IN THE FCA'S RELATIONSHIP WITH FIRMS

We consider that the FCA's proposals will lead to a material deterioration of the relationship between the FCA and the firms that it regulates, with that relationship becoming more adversarial. Two of the most significant ways in which we anticipate this may occur are described below.

First, we expect that the proposals will cause firms to become more cautious in the disclosures that they make to the FCA, in circumstances where such disclosures might lead to the immediate public announcement by the FCA of an investigation into the issues concerned. The consequences of this disclosure process becoming more adversarial were well summarised by the FSA in DP08/3:

"Some commentators dismiss this concern as 'cosiness' with the industry and argue that we should not have to rely on voluntary provision of information to do our job effectively. But we would then become reliant on the formal information-seeking powers provided to us under FSMA, rather than

on the more informal requests we mainly use now or indeed the many spontaneous submissions and notifications we receive from firms. Again, such formalising could become legalistic and increase the time and effort involved in all our monitoring and discovery activity, thus radically reducing the number of firms it would be possible to scrutinise."

Second, we anticipate that the FCA's proposals will lead to an uptick in firms electing to "leapfrog" the FCA's more collaborative RDC process and opting to take enforcement cases straight to the Upper Tribunal. That is because, at present, one of the main advantages of the RDC process for firms is that it presents them with the opportunity to seek to resolve matters with the FCA in a confidential forum. In circumstances where details of an investigation are already in the public domain, that benefit is, to a large extent, taken away. The balance may then, for many firms, be tipped in favour of progressing straight to the more formal Upper Tribunal process.

RISKS FOR INDIVIDUALS

We welcome the FCA's confirmation that, in light of the restrictions placed upon it by the UK GDPR and the ECHR, it will not usually announce the opening of investigations into individuals.[2]We are, however, concerned that decisions to announce the opening of investigations into firms could still have a serious impact on individuals.

The content of the FCA's proposed announcements in relation to firms will, in many instances, make it obvious that the FCA will be looking into the conduct of certain individuals (for example, in an AML investigation it will be obvious that the FCA will be examining the conduct of the MLRO). The risk of this occurring is particularly heightened at smaller firms.
We are extremely concerned about the potential identification of individuals for a number of reasons:

a. as the FCA readily acknowledges, individuals have rights pursuant to the ECHR and UK GDPR which the FCA is prohibited from infringing;

b. section 393 FSMA grants individuals "third party rights" if they are prejudicially identified in an FCA warning or decision notice. In stark contrast, the FCA's proposals offer no equivalent protections in the context of its proposed announcements; and

c. the impact on individuals could be significant. The proposed announcements may well fuel speculation about individuals among their colleagues, in the press and across the market generally. It goes without saying that this could have a serious impact on their ability to stay in post, their future employment prospects and their mental health, all in circumstances where they may not even be under investigation by the FCA or may be subject to an investigation that is discontinued.

In addition to the above, we are also mindful that the announcement of investigations into firms by the FCA may prompt other bodies, such as parliamentary select committees, to conduct their own

investigations into the same matters. In those circumstances, the risks of the names of any individuals that the FCA is investigating coming into the public domain also becomes heightened, given the UK GDPR exemptions that apply when responding to questions from such select committees.

LITIGATION RISK

It is well-known that the UK is experiencing an ever-increasing trend for mass litigation and FCA-regulated firms often find themselves to be targets of this.

The litigation funding and claimant law firm market is particularly buoyant at present and is closely monitoring announcements by regulators, as these often provide both a foundation for building claims and a route-map for progressing those claims. Our concern is that the early announcement of investigations by the FCA will lead to a further increase in the number of mass claims brought against FCA-regulated firms. With claimant law firms in competition to build books of claims they will, no doubt, seize on early announcements by the FCA to commence premature and speculative claims against firms, rather than waiting for it to reach conclusions.

This will, of course, be detrimental to firms, particularly if the FCA later closes its investigation without further action and the firm is then left with live litigation that must be disposed of. However, this could also cause issues for the FCA. For example, where the FCA is looking to secure redress for customers, its options for effectively achieving this might be fettered if large numbers of customers are already parties to funded mass claims.

OTHER PRACTICAL ISSUES

We also wish to highlight the following additional practical concerns:

a. We understand from paragraph 3.31 of CP24/2 that, if the proposals come into force, the FCA intends to announce not only new investigations into firms but also ongoing investigations where that meets the public interest test. We have concerns about the fairness of this for firms facing ongoing investigations who have, to date, been dealing with the FCA on the basis of a reasonable expectation that the investigation would remain confidential. Moreover, it is unclear to us how the FCA intends to disclose existing investigations – for example, would there be a single bulk announcement, or a series of separate press releases for each investigation?

b. It is unclear from CP24/2 precisely when the FCA proposes to usually announce the opening of a new investigation. We understand from the Roundtable Discussion that this will be following the investigation scoping meeting, but we would be grateful if the FCA could confirm the position?

c. It is not clear from CP24/2 whether, if an investigation into a firm is announced by the FCA, firms will be permitted to make their own announcement. Please can the FCA clarify its position on this?

d. It is unclear from CP24/2 what content the FCA proposes to include in:
   i. the investigation updates referred to in paragraph 3.27. Will these simply be short statements that the investigation remains ongoing or will they provide further detail – please can the FCA confirm?

   ii. the investigation closure announcements referred to in paragraph 3.29. Will these simply state that the investigation has been discontinued or will these contain further detail as to the reasons for discontinuance? We are conscious that, given the potential sensitivity for the FCA in discontinuing an investigation, there may be a temptation for its staff to "spin" any closing press release by focussing on justifying why the investigation was commenced in the first place, rather than on exonerating the firm in question (in particular, we are mindful of Judge Herrington's comments in *Seiler v FCA [2023] UKUT 00270 (TCC)* about the FCA's conduct in relation to the press release in that matter).

ALTERNATIVE APPROACHES

For the reasons set out above, we strongly object to the FCA's proposals to publicise the opening of enforcement investigations into firms where it considers this to be in the public interest.

However, we do recognise and appreciate the FCA's desire to achieve greater transparency. With that in mind, our position is that, if the FCA intends to take action here, its proposals should, at the very least, be modified in one of the two ways below:

a. the FCA's announcement that it is opening an investigation should be anonymised, not naming the firm being investigated; or

b. if the FCA is intent on seeking to name firms in announcements of investigations, it should:
   i. broaden the factors that it takes into account in deciding whether to make these announcements (or provide any updates on the investigation) to expressly include considering both the impact on firms and any identifiable third parties. In our view, the FSA was much closer to the mark in DP08/3 where it recognised that "a balance needs to be struck between various factors, including:
      1. the relevant statutory limits on what we can say;

      2. the potential benefits that could flow from greater publicity of enforcement investigations by demonstrating to the market our concerns about certain areas or conduct, better informing consumers and deterring bad practice;

      3. the scope for publicity to hamper or prejudice investigations and enforcement action or, alternatively, to assist in bringing forward witnesses; and

      4. concerns about the fairness of publicity by us – and, potentially, consequential media attention – potentially prejudicing those who are the subject of an investigation where the

case is ongoing";

ii. provide a credible and fair mechanism for firms and any identifiable third parties to make representations prior to the FCA publishing any initial announcement (or any update or closing announcement). For example, we would support an amendment to the FCA's proposals to adopt a process similar to that used by the RDC in respect of Warning Notice statements. This would involve:
    1. the sharing of a copy of a draft initial announcement (or update or closing announcement) with the firm (and any identifiable third party), specifying a time window within which the firm is able to make representations (normally 14 days, but with an opportunity for firms to ask for an extension).

    2. the RDC considering any submissions received and then deciding whether publication of the initial announcement (or update or closing announcement) should be permitted.

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[1] We understand from the Roundtable Discussion that the FCA has concluded from data analysis it has conducted that its proposed early announcements will not have a significant share price impact. However, this appears to contradict the FCA's acceptance at paragraph 3.26 of CP24/2 that some of its announcements will potentially be market sensitive. We, therefore, request that the FCA publishes its data analysis.

[2] Although we would welcome greater certainty and guidance around the more limited circumstances where the FCA will consider such announcements to be necessary.

RELATED PRACTICE AREAS

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