FUTURE OF DISPUTES

The FCA: Looking backwards or forwards?

Wednesday, 11 November 2020, 4.00 - 5.00 pm GMT

Key Takeaways...

from Baker McKenzie's Future of Disputes spotlight session

Current FCA focus

Broadly speaking, the FCA's enforcement priorities haven't changed as a result of COVID but they have adjusted slightly in terms of the risks posed to consumers, the risks posed to firms and to ensure the proper functioning of the markets. The key areas of focus are still broadly:

There has also been some slowing down in the FCA's investigations work. This is reflected in the reduced number of investigations that were opened by the FCA between 1 March and 31 May – from 148 last year to just 36 new cases being opened during the same period this year.

Financial crime

The move to conducting business online as a result of the COVID pandemic has posed new financial crime risks to businesses. There is the increased risk that criminals are taking advantage of the pandemic to carry out new types of fraud and financial crime.

There are also clear operational challenges posed by the remote working environment. These may include, for example, difficulties in carrying out customer due diligence face-to-face and delays in reviewing transaction monitoring alerts.

What can firms do?

- Review the financial crime control framework, especially risk assessments, to respond and react to new threats.
- Conduct CDD and ongoing monitoring remotely. If necessary, the FCA has said that delay may be reasonable where the firm (i) does so on a risk basis, (ii) plans a clear path to return to business as usual, and (iii) carries out conformance reviews or investigations as soon as possible.
- Keep open channels of communication with the FCA, particularly of any material issues that are impacting the effectiveness of the firm's financial crime controls or causing significant delays to remediation plans.
- Decisions to amend controls should be clearly risk assessed, documented and go through appropriate governance.
- Firms should not simply change their risk appetite to reduce the operational burden, e.g. by switching off or changing transaction monitoring triggers/thresholds or sanctions screening systems for the sole purpose of reducing the number of alerts generated.

Cyber security

Unsurprisingly, there has been a significant increase in cyber attacks this year. In part, due to the working from home arrangements and more individuals using personal devices for work purposes. Which in turn increases vulnerability to cyber attacks. The National Cyber Security Centre (NCSC) recently released a drill for managing cyber incidents when working remotely which is very worthwhile taking a look at and can be accessed here: https://www.ncsc.gov.uk/information/exercise-in-a-box

> "The NCSC has noted a three-hold increase in ransomware attacks this year. It is also increasingly common for attackers to threaten to leak sensitive information until payment is received."

At Baker McKenzie, we have already seen some instances of the malicious insider attacks over the past few months — usually in the case of redundancies and the theft of confidential information. It is interesting to see how involved the FCA was in those cases in evaluating the strength of the firms' surveillance and detection controls.

Financial reporting

Pre-COVID, spurred on by a number of high profile corporate collapses (e.g. Arcadia, Carillion and Debenhams) the FCA had been indicating a more aggressive stance and we saw a gradual uptick in enforcement notices which included allegations of financial misreporting and market manipulation.

The COVID pandemic saw a temporary suspension of the wrongful trading rules and when creditors can serve statutory demands and winding up petitions, and of the duty under the Companies Act 2006 that normally requires the accounts of a public company to be filed within six months of the end of the accounting period - these changes came to an end in September.

That pre-existing appetite on the part of the FCA and FRC to see effective financial reporting – and to be seen to police it – we predict will develop into deeper investigation into the adequacy of financial controls and reporting/audit output.

KEY TAKEAWAYS

1 While the FRC will continue to place heat under the audit process, the FCA will return its focus to the adequacy of financial systems and controls.

2 Alongside this, the FCA will employ the Senior Managers Regime to pre-bake personal accountability in the finance function.

3 We can therefore expect an increase in Senior Manager Arrangements, Systems and Controls (SYSC) enforcements and appetite on the FCA's part to employ the criminal jurisdiction created by the Financial Services and Markets Act 2000 (FSMA).

4 As a final thought, while the FRC squeezes auditors they will, in turn, squeeze companies they audit to disclose facts, waive privilege, estimate contingent liabilities, apply aggressive provisioning and liability reserve strategies, apply a conservative approach to write-downs and a substantive level of explanation and justification in trading statements.

The changing nature of the risks

One area where we are likely to see a lot of future FCA enforcement activity is in relation to market misconduct and, in particular, insider dealing. There has been a lack of ability to conduct physical surveillance within businesses. People are working from home where they are simply not physically proximate to anyone in their firm. This results in two phenomena: the first is that people are less inhibited about misbehaving, because they know their activity is less likely to be caught. Second, if there is misbehaviour, as a matter of fact it will be less likely to be caught.

What can businesses do to protect themselves?

- Ideally firm's CVs on culture will already be in good shape. It's certainly a good time for firms to take opportunities to reinforce their culture messages.
- Checking existing surveillance is fit for purpose. Is it looking for evidence people are moving off visible platforms? If they are moving off visible platforms, is it capturing that activity?
- Hyper-vigilance on personal account (PA) dealing: are firms checking with the right frequency, and the right rigour?
- Investing in whistleblowing programme - marketing it internally, reassuring staff as to protections afforded to whistleblowers.
- Instigating dialogue with the FCA about all of these steps you are taking. Getting ahead of the message with the FCA should be of some benefit in distancing a firm from employees who misbehave if it ever comes to that. Hopefully it will also make the firm a less enticing target for future enforcement activity.
- Acting quickly and seriously in response to any suspicions: they need to investigate quickly, and thoroughly.

Whistleblowing

A FOIA request from **March 2020** shows there was a **40%** increase in reports to the FCA between 2018 and 2019.

Depressed market conditions often result in an uptick in whistle-blower reporting (internally, to regulators and to the press or public).

To encourage employees to report concerns internally, it's important that businesses do everything they can to instil confidence in BAU reporting channels and whistle-blower programmes.

Top tips include:

- providing a "thank you" to whistle-blowers - there is anecdotal evidence that this relatively simple gesture can encourage engagement in internal reporting,
- encourage a "speak-up culture" and the use of BAU reporting channels, and
- provide a channel for confidential (but not necessarily anonymous reporting) - this can help reporters feel more engaged and can benefit investigators who may have follow-up questions

To help ensure whistle-blower reports are managed effectively:

- triage whistle-blower reports to ensure reports are allocated resources efficiently and effectively, and
- maintain a clear audit trail of whistle-blower investigations and decision making - it may be necessary to explain your actions several years after the fact.

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