

## ENFORCEMENT UNDER THE NEW UK REGULATORY ARCHITECTURE

On 1 April 2013 the UK Financial Services Authority was replaced by a new set of regulators: The Financial Conduct Authority (the “FCA”); the Prudential Regulatory Authority (the “PRA”); and the Financial Policy Committee (the “FPC”). This follows the passing into law of the UK Financial Services Act 2013.

The new regulators represent the latest in a series of steps taken by the UK government to reform regulation of the UK’s financial services sector following the 2008 financial crisis. The new UK regulators have also gained additional powers of investigation and enforcement. This note provides a brief overview of the roles and responsibilities of the new regulators before focusing more directly on some of the new powers given to the FCA and PRA.

### The New Regulators

The roles of the new regulators will, broadly, be divided between regulation of conduct and markets by the FCA; micro-prudential regulation by the PRA; and macro-prudential regulation by the FPC:

**FCA** – The FCA is responsible for regulating the conduct of UK authorised firms, in addition to the prudential regulation of certain firms that are not considered systemically important (such as most investment firms). It is also responsible for regulating retail and wholesale financial markets, which includes monitoring and enforcement of market abuse and insider dealing.

**PRA** – The PRA is a subsidiary of the Bank of England and is responsible for the prudential regulation of firms that are considered systemically important to the UK financial system. These include banks, building societies, insurers and certain larger investment firms. The PRA will have certain powers of investigation and enforcement over those firms that it regulates.

**FPC** – The FPC is responsible for macro-prudential regulation and will monitor issues that affect the whole of the UK financial system, as opposed to prudential regulation of individual firms. The FPC may direct the PRA or FCA to take action in order to address systemic risks to the UK financial system.

### Key Changes to Powers of Investigation and Enforcement

Both the FCA and the PRA have been given certain new powers in relation to their investigation and enforcement roles, beyond those held by the FSA. Whilst the FCA will be the key regulator responsible for enforcement of matters relating to conduct (including taking regulatory action to counter financial crime) and markets (such as market abuse and insider dealing), the PRA will still retain an enforcement role for ensuring regulatory compliance by those firms that it regulates.

**Early announcement of enforcement proceedings** – The FCA and PRA can publish the fact that a warning notice has been issued, along with a summary of its content. A warning notice is the first stage in formal enforcement proceedings. Under the previous regime the FSA was not allowed to publish any information about enforcement proceedings until it had issued a decision notice, a much later stage in any such proceedings and frequently following settlement negotiations, such that the document was negotiated. The earlier publication of possible enforcement outcomes may lead to attempts to settle the matter earlier.

The FCA notes that the principal purpose of this power is to promote early transparency of enforcement proceedings, in line with a newly introduced principle that regulators should exercise their functions as transparently as possible. However, the early publication of warning notices has proved one of the most controversial new powers given to the FCA and PRA, in particular because warning notices may be issued before a firm has had a chance to respond fully to the allegations against it.

The FCA and PRA are required to consult with the person who is the subject of a warning notice before its publication; however, the decision as to whether to publish such information is at the discretion of the relevant regulator. The law does provide that the regulator is not permitted to publish a warning notice if, in its opinion, publication would be unfair to the person with respect to whom the action was taken (or was proposed to be taken), among certain other limited restrictions.

This provision will apply to any warning notice issued on or after 1 April 2013, although the FCA is currently consulting with stakeholders on its use and has noted that it will not publish any warning notices until that consultation has ended (sometime after the deadline for responses on 18 June 2013). The PRA has published its statement of policy covering publication of warning notices, noting that it will not publish information if, in its opinion, it would be unfair to the persons concerned; prejudicial to the safety and soundness of PRA-authorised persons; or prejudicial to securing protection for policyholders.

**Document retention powers** – The FCA and PRA can retain original documents obtained through either their information gathering powers, or documents seized under a warrant, for as long as necessary in the circumstances. However, an owner of a document seized under a warrant can apply for a court order requiring the return of the document.

Previously the FSA had only the power to take copies of documents requested under its information gathering powers and could not obtain originals. It also had an obligation to return original documents seized under a warrant within three months (or at the end of criminal proceedings to which the document was relevant, if they began within three months of the documents being seized).

**Power to appoint a skilled person** – Under the new regime the FCA and PRA will have the power to directly appoint a ‘skilled person’ to produce a report into an authorised person’s business or conduct. The term ‘skilled person’ is not a defined term but tends to refer to the appointment of professional firms, such as accountants or solicitors. The regulators can then recover the cost of the appointment from the authorised person.

Previously the FSA had only the power to require such an appointment by an authorised firm, rather than making the appointment itself directly. In some respects this is helpful where there is a risk of civil litigation in addition to regulatory action. The difficulty with the previous regime was that as the skilled person was appointed by the firm, its draft reports were provided to the firm and to the FSA, therefore making them disclosable in civil proceedings (they were not legally privileged). However, when the FCA appoints the skilled person it may be possible for the reports to be sent to the FCA and the person to then inspect them, such that they are not in the possession of the person that they relate to and therefore disclosable in civil proceedings.

**Powers over unregulated parent undertakings** – The FCA and PRA can give directions to certain unregulated parent undertakings of authorised firms to take or refrain from taking specified action. They may also make rules requiring the provision of information relevant to the regulator's function by such parent undertakings. Where a parent undertaking contravenes any such requirement imposed upon it, the relevant regulator has the power to impose financial penalties on it. The FSA could not previously take such action against an unregulated parent.

These powers will apply only to the parents of UK regulated firms where the subsidiary is either regulated by the PRA, or is an investment firm regulated by the FCA. In addition, they will apply only to unregulated parents that are themselves bodies corporate and are either incorporated, or have a place of business, in the UK and are, broadly, in the business of acting as holding companies for insurance, credit or investment firms.

Both the FCA and PRA have produced draft statements of policy regarding these new powers in which they set out possible scenarios for their use. The FCA, for example, has suggested it may use these powers to force compliance with regulatory requirements or prevent 'disorderly failure' of a regulated entity or its group.

## **Comment**

The FCA is expected to continue where the FSA left off in pursuing criminal and regulatory sanctions against non-compliant firms under the banner of 'credible deterrence'. Given its new powers, and in particular the prospect of much earlier publication of enforcement proceedings, firms will need to continue to ensure ongoing compliance with regulatory requirements and be aware that enforcement proceedings may become public at a much earlier stage.

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