Personal accountability for those working in a regulated environment

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Objectives & Agenda

Question: Is there greater regulatory activism against individuals?

1. Lloyd's disciplinary process
    - Decisions

2. FCA's enforcement regime
    - Decisions
    - SMCR

3. Guernsey Financial Services Commission

Nobody expects the Spanish Inquisition!

“Fear, surprise, ruthless efficiency”

What the FCA used to say:

“Shoot first and ask questions later”

(Martin Wheatley, FCA Chief designate, 2012)

What the FCA now says:

- "*Starting an enforcement investigation is a diagnostic tool and does not mean a sanction is inevitable or even likely." (*Our Mission 2017)

- *"The legislation creates some very low thresholds and that is deliberate….giving the FCA wide discretion to act where there are* ***serious concerns*** *but not much hard evidence to really go on."*

- *"This means we should investigate where we suspect* ***serious misconduct*** *[i.e. not trivial, technical or officious] may have occurred"*

- *"It is a fundamentally different process to litigation where we have a view about what has happened. When we are investigating,* ***we have not concluded any view about what has happened.***

(FCA Director of Enforcement and Market Oversight "A Better View" September 2017)

What does Lloyd’s say:

- Lloyd’s 8 strategic priorities 2017/19
- Market Oversight
- requires the Corporation to play an active supervisory role. This role covers performance management, capital setting and risk management.
- The Corporation needs to ensure that supervision of the market is effective and in this regard we are accountable to both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). It is, however, a key objective for us to minimise duplication with work undertaken by the PRA and the FCA.

FCA/Lloyd's co-operation arrangements

Legal Intervention

9. Subject to any legal or regulatory requirements, the FCA and Lloyd's will share information in respect of investigations or disciplinary or enforcement action in relation to:

(a) Managing agents
(b) Approved persons holding controlled functions for or on behalf of managing agents
(c) Individuals who act or have acted for or on behalf of managing agents
(d) Any other person subject to the jurisdiction of Lloyd's (including members, directors of corporate members, Lloyd's brokers and annual subscribers
(e) Lloyd's coverholders.

Lloyd’s disciplinary process

- Market Bulletin Y4795, May 2014
- Enforcement Proceedings – Framework for Enforcement and Sanctions
- Misconduct for those subject to Lloyd’s jurisdiction
- Contested hearing/settlement
- Lloyd’s Market Supervision and Review Committee determines sanctions/brings enforcement proceedings
- Settlement subject to approval by Lloyd’s Enforcement Board
- Sanctions include:
  - suspension/exclusion
  - Fine
  - Censure
  - Restitution/disgorgement
  - declaration of unfitness to act as director

Lloyd’s disciplinary process (continued)

- Overriding principles, sanctions should promote:
  - high standards of conduct
  - promote confidence
  - act as a deterrent
  - fair/proportionate
  - take account of previous conduct

- Approach is to seek censure and consider restitution

- Then determine if further sanctions should apply

Lloyd’s disciplinary process (continued)

Sanctions against individuals:

- Seriousness of misconduct
- Fine: based on ‘relevant income’
- Gross benefits received from employment/ in connection with misconduct over the years the misconduct occurred

Level of Misconduct	Suspension	Fine (Starting Point)	Censure
i – discreditable conduct (dishonesty)	Permanent	40%	Yes
ii – discreditable conduct (Reckless misconduct)	5yrs – Permanent	30%	Yes
iii – discreditable conduct (gross negligence)	2yrs – 5years	20%	Yes
iv – detrimental conduct	0 – 2yrs	10% - 20%	Yes

Lloyd’s disciplinary process (continued)

- Unwilling to accept public “undertakings” from individuals in lieu of formal suspension.
- Mitigating/aggravating factors
- Adjustment for deterrence
- Settlement discount (Settling at early stage)
- Cost

Lloyd's disciplinary process (continued)

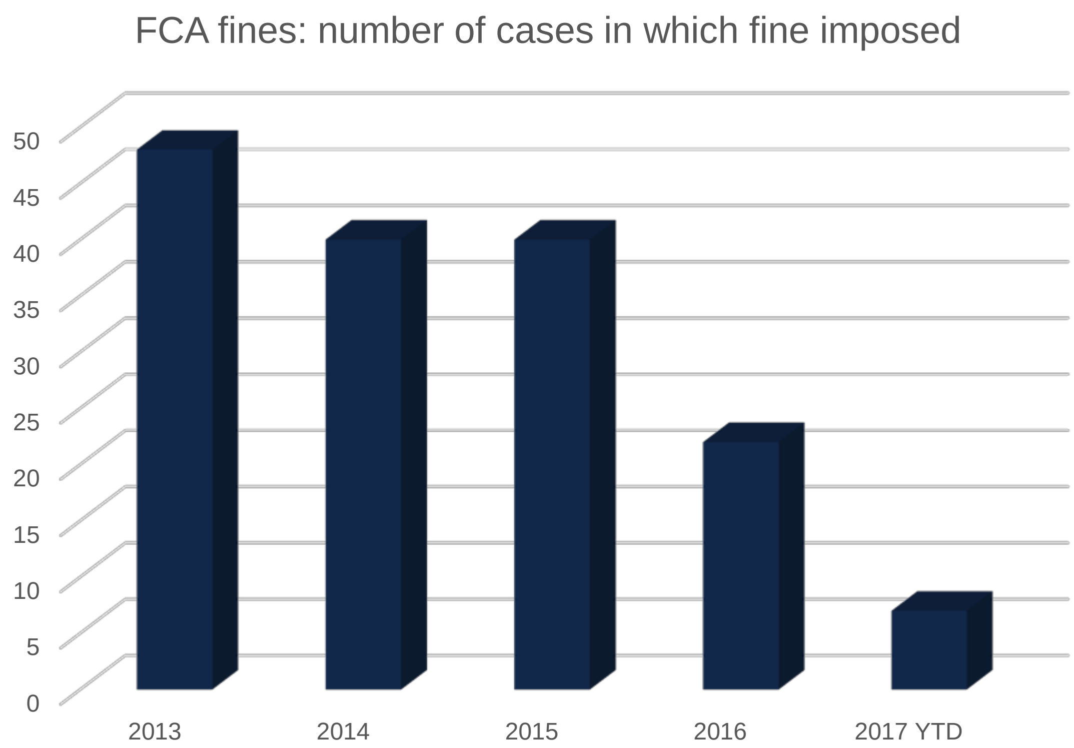
Examples

1. Broker (March 2017)
   - Concealment of brokerage
   - Dishonest deception of 3rd party
2. Underwriter (Sept 2016)
   - Improper use of confidential information
3. Directors of Managing Agent (Aug 2008)
   - Failed to deal with capital provider and Lloyd's transparently
4. FD/Active underwriter (March 2013)
   - Failed to put in place proper systems & controls for reserving
5. CEO of Managing Agent (February 2013)
   - Failed to ensure board had sufficient MI to monitor claims deterioration.

– BUT: Only two reported decisions since May 2014 Market Bulletin.

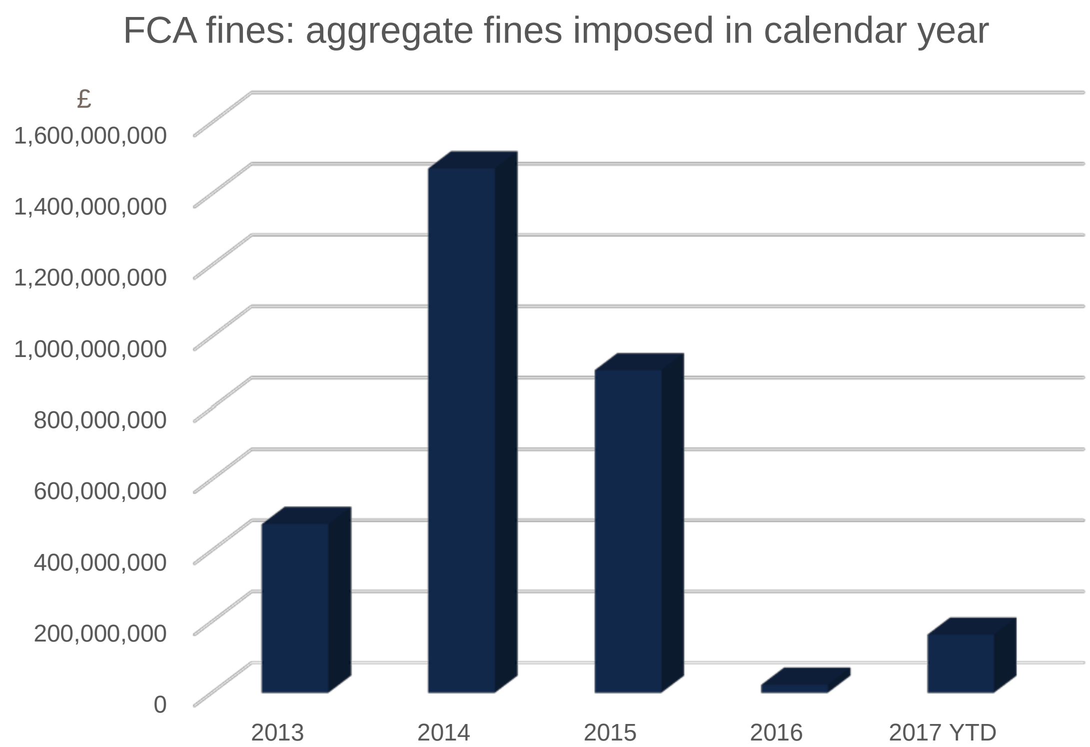

models leave robust levied
similar Speech showing industries increased future
Statistic regulated However found taking
metaphor head questions Osbourne Arrangements
business spokesperson pension certain swiftly
party bank flaw forgive arrangement tough bodies
result recovery later banks aggressive tackle
finding co-ops retracted scary operating needs decreased four abuse
serious Budget obtain people investigate
wider Service replacement abuses shoot room switching
financial Pension unauthorised two one
use need watering statement non-compliance
sanctions vote want close misselling regulator replaced
regulatory following managers Britain companies
now year prosecutions
number trajector entering Wheatley vulnerable circumstances
years resigned months honest difference
Former may senior strong conduct
failing average ask key clamping time
prison fail information documents delegate
aware interest Hammond firms type record made allow
first past Insolvency issued
George providing 1.4bn quite
FCA power fleece
though Evidence implications meant
foreign fines exploit regime frankly
avoidance March given good schemes arise advice
system sentence
follows
action

FCA fines in 2017 (1)



Source: research by CMS
Data from www.fca.org.uk
for calendar year, as at 7
October 2017

FCA fines in 2017 (2)



Source: research by CMS
Data from www.fca.org.uk
for calendar year, as at 7
October 2017

FCA fines: explaining the trends (1)

Speech by Mark Steward - 19 January 2017

"*Has light touch returned?* ***Have we gone soft?*** *For many of you today, the answer may be disappointing because it is* ***a very clear 'no'****.*"

"At the same time, I think there has been a change that is worth discussing. I think this is creating a different dynamic. The change or inflexion is the commencement of the ***senior managers regime*** *which imposes what is called a duty of responsibility on senior managers and which commenced in March 2016…*"

Speech by Jamie Symington - 15 June 2017

"*The Financial Crisis of 2008 saw* ***unprecedented turmoil in markets****. The regulatory response was far reaching. Confidence in the financial system was further damaged in subsequent years by the uncovering of widespread conduct issues in the Libor and FX markets."*

"Investigation and enforcement response for regulators took us into new territory. We dealt with a vast array of issues across all sectors. Large, cross-jurisdictional investigations were carried out involving multiple parties and multiple agencies. ***Records for fine levels were broken and broken again.****"*

"The response needed at the time was one that would restore order, stability and confidence in the markets. And do so quickly. ***As things have returned to relative stability, there has been time to reflect...***"

"*Where* [...] *suspected misconduct is considered to be serious, and harm or potential harm is sufficiently significant to warrant investigation,* ***then we would expect to open an investigation.****"*

FCA fines: explaining the trends (2)

Speech by Jamie Symington - 15 June 2017 (cont)

- *"it is likely that **proportionately fewer of our investigations** will progress to disciplinary enforcement action"*
- *"there are multiple responses that might be appropriate **other than imposing sanctions on or prosecuting people**. It could be that the consequences of an investigation are that we do nothing further."*
- "*The key point is that **a matter is not passed to Enforcement only so that Enforcement can do its best to bring an enforcement case**. An investigation is opened because we want to understand what happened.*"

The FCA <u>is</u> opening many new Enforcement cases

- Significantly more new cases opened during 2016 compared to previous year:
  - 109 opened in 2015-2016
  - **282** opened in 2016-2017 (approx. **158%** up on number opened in previous year)
- 237 cases open at 31 March 2016
- **414** cases open at 31 March 2017 (increase of 177 open cases, approx. **75%** up on previous year)
- BUT **62%** of cases of total cases closed in 2016/2017 were closed with no further action (24% in 2015/2016)
- Data from FCA's Annual Performance Accounts for 2015-2016 and 2016-2017 on <u>www.fca.org.uk</u>

FCA Enforcement Annual Performance Account 2016-2017 – 5 July 2017

"*We remain committed to investigating and holding firms and individuals accountable for misconduct and to ensure wrongdoers pay for the costs of remediation. **There has been no change in our approach to misconduct or financial penalties.***"

When is an investigation started (1)?

- **What the FCA says:**

  - "*Starting an enforcement investigation is a diagnostic tool and does not mean a sanction is inevitable or even likely." (*Our Mission 2017)

  - *"The legislation creates some very low thresholds and that is deliberate….giving the FCA wide discretion to act where there are **serious concerns** but not much hard evidence to really go on."*

  - *"This means we should investigate where we suspect **serious misconduct** [i.e. not trivial, technical or officious] may have occurred"*

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(FCA Director of Enforcement and Market Oversight "A Better View" September 2017)

When is an investigation started (2)?

- **The triggers - FCA Enforcement Referral Criteria**
  - Overall, is an enforcement investigation likely to further the FCA's aims and statutory objectives?
    - The strength of the evidence and the proportionality and impact of opening an investigation
    - What purpose or goal would be served if the FCA were to end up taking enforcement action in this case
- **In practice:**
  - **Gravity** - has there been widespread harm or potential harm to consumers, market integrity or competition? Does it indicates systemic weakness or widespread problem or poor culture or governance at the firm?
  - **Reaction** – how quickly, if at all, the firm brought the breach to the regulator's attention, whether it has implemented remedial action, and the likelihood of repetition
  - **Precedent** – the firm's past conduct, evidence of repeat offending, and what action the regulator has previously taken in such cases
  - **Priority** – the risk of the theme, whether it has issued guidance on this area, priority against other cases that could be referred. Would it send a strong message?

FCA Enforcement regime: individuals/insurance (now)

- Approved Persons regime/individual conduct rules
- Applies to only the most senior individuals in a regulated entity
- Examples (insurance)
  - Broker – failings with CASS oversight & compliance
  - Broker – misapplication of client insurance premiums
  - MGA – failing to use reasonable skill to ensure appropriate contractual arrangements in place to provide effective Sols PI cover

FCA Enforcement regime: individuals/insurance (future)

- FCA 2018/19 Business Plan (May 2018)
  - Priority: Firm’s culture & governance
- Senior Managers Certification Regime (SMCR)
- Inforce for banks (2016); and a varied version for some insurers
- SMCR for all regulated entities in 2018
- Aim: to make individuals more accountable for their conduct
- Senior Managers/statement of responsibility (aka Approved Person)
- Certification Regime (staff who pose risk of significant harm)
- Conduct Rules/apply to all employees (save admin staff)
- **This is a big change!**
  - Act with integrity
  - Act with due care and skill
  - Open and co-operative with FCA/PRA
  - Treat Customers Fairly
  - Observe proper standards of market conduct

GFSC

- GFSC 2017 Annual Report
  - Enforcement: 9 open cases at beginning of year; 12 at end of year
- Concluded actions include:
  - Fiduciary form for AML failures
  - Fund administrator for failing to organise/control its internal affairs
  - Unlicensed individual for illegally providing registered office
- The Commission's general approach to Enforcement (Nov 2017)
- Panel of Senior Decision Makers where findings contested
  - 5 cases before SDMs in 2017
- Where a case is proven SDM determine penalties & period of prohibition
- The Financial Services Commission (Bailiwick of Guernsey) Law, 1987
  - Financial penalties for licensees: up to £4m (max of 10% of turnover)
  - Financial penalties for officers: up to £400,000
- 2018 - one objective is high quality conduct regulation

D&O cover, scope

- Cover as a director of your own group companies
- Outside director cover
- Investigation costs
- Defence costs
- Damages/settlements
- Claimant’s/investigating agency’s costs
- Fines/penalties (if not criminal/contrary to pubic policy)
- Extensions
  - PR cover
  - Tax cover (personal liability for unpaid corporate taxes)
  - Asset deprivation
  - Liberty Costs
  - Mitigation

D&O insurance – personal protection

1. FRC proceedings against Finance Director
   - Defence costs £2m
   - Prosecution costs £800k
   - Fine £57k

2. FCA Enforcement against Compliance Director
   - Investigation & private warning
   - Proceedings to contest that

3. Insolvency Service pursuing disqualification proceedings

4. Liquidators bringing civil proceedings
   - Damages £35m
   - Defence costs £4m/settlement

QUESTIONS

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