A transformed regulator: Important lessons for compliance officers

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The failure of London Capital & Finance Plc in 2019, and the highly critical report by Dame Elizabeth Gloster the following year gave incoming CEO Nikhil Rathi a clear mandate to transform the Financial Conduct Authority (FCA).

Structural changes at the FCA

Criticised by Dame Gloster for being silo-ed, slow to react and poor at supervising firms and identifying risk, the FCA has been undergoing a significant internal transformation programme to facilitate a shift to becoming a data-led and assertive regulator. Indeed, in its 2022 – 2025 strategy paper, the FCA stated that "by acting earlier and more assertively we will prevent harm and intervene before problems become systemic" and this new supervisory approach is likely to impact all regulated firms and their senior managers.

To achieve this ambition, there have been a raft of internal changes at the regulator. New proactive supervisory teams have been established across a range of sectors, particularly those considered to pose a high risk to consumers, including retail lending, payments, appointed representatives and financial promotions. It also has plans for a "regulatory nursery", where newly authorised firms can expect to spend a period of time under intense supervision before they are moved to a standard supervisory department.

One important driver of harm identified by Dame Gloster is the so-called "halo effect", where firms benefit from the badge of respectability that comes with FCA authorisation but which are either not using their permissions and / or are using that regulated status to promote high risk products for unregulated activities. To mitigate against this, the FCA has set up a dedicated "Use it or lose it" team with the specific remit of identifying firm not using their regulatory permissions and to shut them down quickly. Similarly, it is also setting up a "Worst Firms" unit to take assertive action against those firms it considers as posing an unacceptable level of risk to consumers or markets. This is likely to include those firms which conduct substantial amounts of unregulated business, which have unusually large numbers of consumer complaints or which have long and difficult supervisory histories.

Such organisational changes have been underpinned by various process changes, aimed at reducing internal bureaucracy, and process at the regulator. For instance, Policy Statement 21/16 removed the Regulatory Decisions Committee – with its independent legal advisors – from decisions as to whether to use the FCA's own initiative powers, placing this responsibility on FCA Heads of Department and Directors. Similarly, its new cancellation powers under the Financial Service Act 2021 allows the FCA to remove permissions administratively as soon as it considers that they are not being used, rather than having to wait 12 months as it previously did. Whilst such changes may allow the FCA to intervene more quickly, they must be balanced against the potential procedural unfairness to firms who are subject to such action.

The FCA has also committed to accepting a higher degree of legal risk, both in terms of litigating borderline cases and also in acting assertively to mitigate risk where it lacks a complete factual understanding or evidential base. Fundamentally, this iteration of the FCA is more likely to act before a risk has crystallised and to take a difficult case, and be prepared to potentially lose, rather than be seen to do nothing.

Increased use of powers

There is evidence that these changes are having an effect. In 2021 the FCA published 21 Supervisory Notices (meaning it had exercised its statutory powers on its own initiative), in contrast to 10 the previous year and 4 in 2019. These powers can be extremely draconian and can have significant impacts on firms. They will often impose restrictions on a firm's ability to conduct regulated and unregulated business, take on new customers, deal with or dispose of assets and can also involve the removal of a firm's permissions on a without notice basis.

Not only are such powers being used more frequently by the FCA, but it also becoming more aggressive and creative in their deployment. For instance, in June 2021 it unilaterally banned Binance – the world's largest crypto exchange from operating in the UK on the basis that it was not capable of being effectively supervised and was failing to use its regulatory permissions. Other significant interventions include the shutting down of Raedex Consortium Ltd (linked to Buy2Let cars) due to concerns that it was offering unviable investments – notable for the way that the FCA extended the requirements to unregulated group companies – and the freezing of over £1bn in client monies and custody assets held by Dolfin Financial Ltd, which ultimately resulted in the firm entering special administration.

What this means for firms and compliance officers

The FCA has always had teeth. Under Nikhil Rathi's leadership, however, it is more prepared than before to use them. Many firms can expect more intrusive supervision, with the FCA less tolerant of – and more prepared to act against – alleged inadequate compliance with rules, a failure to use permissions, or involvement in the creation or offering of financial products which pose, in its view, an unacceptable level of risk to consumers.

The below tips may assist compliance professionals in navigating their relationship with this changing regulator. Check that your firm is using its permissions and that these are appropriate for its business activities.

- Ensure that your firm has robust systems and controls across its business, is aware of any risks to consumers inherent in its operations and is managing those appropriately.
- Consider the extent to which your firm is undertaking unregulated activities, whether these are appropriate in light of its regulated status and whether they pose any risk to consumers.
- Respond promptly and constructively to requests from the FCA, whether these are made on a voluntary basis or pursuant to formal powers.
- If visited by the FCA ensure that you understand the reasons for the visit, engage sensibly with the regulator's visit team and ensure that key staff are available to answer questions. In this regard, developing a playbook for dealing with FCA visits may be a useful exercise.
- If sent a draft voluntary requirement (VREQ) by the FCA, consider carefully whether its scope is appropriate and also how any resultant publicity – such as it appearing on your firm's FS Register entry would impact your business. You may also wish to consider what alternative approaches may be available, for instance, offering the FCA an undertaking. Note, however, that the FCA may be less willing than before to accept undertakings.
- If subject to the use of an own initiative requirement (OIREQ), carefully consider what actions need to be taken to comply with it and how it will impact your operations and any third parties.
- If you wish to challenge an OIREQ, consider whether the most appropriate course of action is likely to be providing representations to the decision maker or referring the case directly to the Upper Tribunal. Each forum has different powers (e.g. only the decision maker can vary a requirement), and the best approach will ultimately depend on your ultimate objectives and resource.

In all cases, taking appropriate legal advice at an early stage can help mitigating the impact of supervisory intervention.

Complaints Procedure

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