TECHNICAL & LEGAL

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FCA Approach to Supervision and Enforcement – Implications for D&O & PI Insurance

The FCA has recently published two papers: (i) Approach to Supervision; and (ii) Approach to Enforcement. These papers continue the FCA's drive to be more transparent. They provide greater detail on the FCA's approach to regulation, as well as providing practical guidance to those entities regulated by the FCA.

Both papers are open for consultation until 21 June 2018. The FCA requests views on whether the FCA's papers set out the approach to supervision and enforcement clearly, or if there are any other issues that it would be useful for the FCA to clarify.

In this article, we touch on some of the main themes from the two papers and their relevance to the insurance of financial services entities.

APPROACH TO SUPERVISION

The Supervision paper sets out a statement of the principles that guide the FCA's approach to supervision, as well as its priorities and some of the mechanisms used to supervise. The FCA explains that business models, the culture of firms and their prudential soundness are key areas in the FCA's supervisory approach.

The FCA recognises that the strategies and cultures of financial services firms are the root cause of most major failings that have occurred over the last decade - causing harm both to consumers and financial markets. Fines and penalties flowing from enforcement action to punish misconduct are alone not enough and the FCA realises that it needs to be "*more forward-looking and pre-emptive in its supervision of firms*".

One example of this approach by the FCA is the recent implementation of the Senior Manager & Certification Regime (SMCR) which is being rolled out to all financial services firms (and has been discussed in our previous articles (refer to our bulletins on SMCR and Whistleblowing) making it clear to senior individuals that they will be held to account. Through the SMCR the FCA sets out five conduct rules which will apply to most employees and which clearly establish the FCA's minimum standards of expected behaviour.

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Supervisory intervention from the FCA is more likely to result in internal business costs (as compared with enforcement action, where the appointment of external lawyers is more likely). However, there are occasions when external costs may be incurred, and it may be possible to recover these costs under Directors & Officers or Professional Indemnity insurance. A skilled persons report is an example of such a process highlighted in the FCA paper, and is a consideration which firms should explore as having covered under insurance (although that coverage will not always be available, or may only be available retrospectively if an enforcement action is subsequently commenced by the FCA).

More generally, firms that are able to explain to insurers that they have policies and procedures in place designed to push the firm down the FCA's priority list makes that firm a more attractive insurance proposition. The FCA Supervision paper is a helpful guidance document to financial services entities in that regard.

APPROACH TO ENFORCEMENT

The Enforcement paper sets out the FCA's process for early detection and resolution of harm, the FCA's powers of investigation and the sanctions and remedies that the FCA can pursue. The paper serves as a reminder that the FCA has many routes open to it, including compelling attendance at hearings and production of documents, and pursuing civil and criminal proceedings.

It is important to ensure that relevant insurance policies (principally Director & Officer, but also Professional Indemnity) provide cover for the action that the FCA can take. Formal FCA action is, invariably, covered in modern policies, but it is important to ensure that policies reflect the latest thinking from the FCA on its approach to enforcement which can start on the basis of a more 'informal' footing.

In recent years, the FCA has moved away from commencing a formal procedure at the outset, and often now takes a more informal approach (for example, inviting a director to interview rather than compelling attendance). It is important to ensure that coverage is triggered by such informal action and that an insured has access to the policy at this earlier stage. We envisage that this will make it easier for the FCA to target individuals – so it is important that the triggers in the policy are correct and individuals can access the cover for their legal costs. Policies also need to deal with self-reporting and whistleblowing and we have adapted our JLT wordings to factor in these trends and ensure the broadest possible cover.

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The paper also provides guidance on how to avoid enforcement action. In particular, firms are advised not to wait for the FCA to intervene before taking appropriate remedial action. Whilst the costs of such remedial action are unlikely to be covered by insurance (unless it can be shown that such action is mitigating actual third party claims), taking steps to avoid enforcement action and avoiding claims on the policy will lead to a better claims record and a more favourable negotiating position for policyholders when renewing policies.

STAYING AHEAD OF THE GAME

What remains to be seen is whether the FCA's approach and aim to tackle the root cause of misconduct does in fact succeed, or rather whether further regulation such as the SMCR simply leads to increased enforcement action. From an insurance perspective, we will continue to monitor the FCA's approach to ensure that policies provide the widest protection possible to firms and individuals who need to defend FCA approaches whether formal or informal.