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Underperforming, overreaching

Amid the disruption and turmoil of 2020, the Financial Conduct Authority's ability to achieve certain of its longer-term objectives took some heavy blows. But, even beyond the pandemic, there is criticism of its oversight of investment scandals as well as unease that the current conduct agenda is delving into areas where a financial regulator has no right to go. **Julian Sampson** ponders the sector's status during these tumultuous times.

As we look back at 2020, there'll be no shortage of analysis as to what went wrong and what could have been done better. While most of these analyses will be directed at the Government, the FCA will not escape this scrutiny. Nor should it, as the whole purpose of looking back is not just to find out what happened, but to see if there are lessons that can be learned in order to prevent further recurrence.

The first indications for the FCA are not good. Falling levels of enforcement and increased inefficiency, due perhaps due to Covid, have combined with a shift in focus away from financial misdemeanours to a wider – and perhaps more 'woke' – agenda. We all need to consider where this might lead, irrespective of whether we might or might not welcome these developments.

No one could deny that it's not been a stellar year for the FCA. Even in normal times the appointment of a new chief executive would lead to some disruption and require some bedding-in time; but this year the appointment in October of Nikhil Rathi came in the middle of the pandemic.

The FCA's continued reaction to Covid-19 has been to support the government guidance that financial services staff should work from home where they can. "Firms should continue to follow government advice on working from home until notified otherwise. Where office workers can work effectively from home, they should do so over the winter. Anyone else who cannot work from home should go to their place of work," the regulator says on its website.

The FCA has implemented this policy itself and provided staff with resource to allow them to do so comfortably. Whether FCA staff really needed the "gaming computer screens and racing car-style office chairs" that *The Times* reported on 24 November had been bought for them is open to question, but the regulator certainly thinks so. The FCA said in a statement responding to *The Times* investigation: "We have a responsibility for our staff's health in their working environment, and it is only right that we support them to be able to work effectively. For example, having a suitable place to sit and work and a computer screen. As a result, we allowed staff to make reasonable expense claims." But having done so, it's unlikely that FCA staff will be hurrying back to the office. A nice chair and screen at home must make the daily commute to Stratford seem less appealing.

But 'So what?' you might ask. Aren't many firms experiencing more efficiency, greater well-being and no loss of productivity from WFH? Is the business of financial regulation not carrying on? I'm not so sure that it is – and I'm not so sure that the FCA really believes it, either, in spite of all the exhortation. The FCA knows that they've had to delay the publication of consultation papers and the implementation of new rules. Julia Hoggett, FCA director of Market Oversight, said in a speech on market abuse in October that "our expectation is that going forward, office and working from home arrangements should be equivalent." This echoes the FCA's website, which continues to exhort firms to have the same control environment in a Covid world as in a non-Covid world. "In the current climate, it is important for firms to maintain effective systems and controls to prevent money laundering and terrorist financing," it says.

And that's difficult to do. The plain fact is that misdemeanours are more easily perpetrated from the privacy of your own room, without your team around you or your manager nearby. All the technology in the world is not going to pick up on those changes in demeanour, attitude, concentration and focus that might alert the vigilant manager to something that was amiss.

Just as firms may not be able to supervise staff who are WFH as well as if they were in the office, neither can the FCA oversee firms as effectively, for the same reasons. It was reported in the *Financial Times* in October that "only 36 new enforcement cases were opened between March 1 and May 31 this year, compared with 148 during the same period in 2019. Of these cases, those involving companies were more sharply reduced, with only 14 being started between March and May, compared with 73 in the same period one year earlier. New cases against individuals fell to 22, from 75 a year earlier."

The *FT* reported that Douglas Cherry, a partner at law firm Reed Smith, which obtained the FCA data through a Freedom of Information Act request, said the sudden drop in regulatory activity reflected the "organisational challenges" of trying to pursue companies and individuals when officials were having to work from home.

And even on a lower level, we've all seen increased inefficiency from the FCA this year – the number of surveys that have been sent out is just one example. Of course, these are a key information-gathering tool for the regulator. But why have so many similar ones been sent from different sources? Why, when we're told by the FCA to beware of spoof surveys, are surveys sent out from non-standard FCA email addresses and without the FCA advising their own Supervision Hub or communications team that these are imminent?

So, we wait to see how these ominous portents will play out in 2021. But these aren't the only auguries extracted from 2020. December saw the publication of the Gloster Report into the FCA's handling of the London Capital & Finance collapse, which made for truly depressing reading. There were whistles blown on numerous occasions, but they were neither heard nor listened to. FCA staff were poorly trained and the publications team, who looked at the LC&F adverts, didn't speak to the Supervision team. All of this to such an extent that Andrew Bailey, the FCA chief executive at the time and now Governor of the Bank of England, was forced to issue a public apology after the report's publication. Amazingly, Bailey tried to avoid taking public responsibility for his actions. The inquiry expressed its "disappointment" at attempts by some, including Bailey, to deter the findings from singling out individuals for their failures. The report cited representations made on behalf of Bailey and Jonathan Davidson, FCA executive director of Supervision, Retail and Authorisations, who was another senior FCA official criticised, "to delete references to 'responsibility' resting with specific identified/identifiable individuals". So much for a culture of senior management responsibility there, then. Just do as I say, not as I do.

One thing's for sure, blame for these failures cannot be laid at the door of Covid. They took place over the period from 2016, when the FCA was not distracted. Or was it distracted? Have other issues crowded out the resource devoted to firm supervision?

On this question I'd look at the FCA's current focus on non-financial misconduct, an issue that has been gaining increasing prominence. The idea here is that individuals who display unacceptable behavioural traits in the workplace are likely to be the same individuals who engage in financial misconduct. Thus, if you're a workplace bully, you're likely also to be impervious to criticism. If you exhibit sexist behaviour in the workplace, you're likely in addition to be intolerant of other ideas. The FCA has a long track record in speaking out on these issues. Megan Butler, executive director of Supervision said as long ago as September 2018 in evidence to the Parliamentary Women and Equalities Committee that FCA "view sexual harassment as misconduct which falls within the scope of our regulatory framework". And the reason for this is that "culture in financial services is widely accepted as a key root cause of the major conduct failings... A culture where sexual harassment is tolerated is not one which would encourage people to speak up and be heard, or to challenge decisions."

So much the better, you might say. The threat to all of us from racist and sexist behaviour, or the threat to the planet and our environment is far more important than the threats of misconduct to a few individuals' pensions. To that end, the FCA's focus on this poor behaviour – and an increasing focus on environmental issues – is exactly the right thing, which will deliver greater communal good.

And recent developments have taken these initiatives to a new level. On 5 November, the FCA tossed another lighted firework into the room when it announced that it had banned three individuals from working in the financial services industry. Make no mistake, the three individuals had committed serious crimes and were generally sentenced to custodial terms, but none of the offences took place in a work context. They were all in their private domains.

In justifying this action, Mark Steward, FCA executive director of Enforcement and Market Oversight, said: "The FCA expects high standards of character, probity and fitness and properness from those who operate in the financial services industry and will take action to ensure these standards are maintained."

The crimes committed here were so clear-cut that this ban doesn't help regulated firms who are struggling to deal with far more nuanced cases of conduct in the workplace – let alone in employees' home lives. Was the FCA wanting to signal society's condemnation of such actions? But surely the courts – and the sentences imposed – have already done that. It's tempting to conclude that all the FCA were doing is 'me too' virtue signalling. One is further tempted to conclude that the only tangible outcome that the FCA has achieved in

banning these three is to deny them the means of earning their living once they've served their sentences, forcing them to at best re-train or at worst become long-term claimants.

But if the FCA is going to ban those against whom a criminal conviction for non-financial offences has been made, where does this stop? I remember two years ago presenting to a client on non-financial misconduct. An attendee asked whether the FCA were in the future going to be interested in their speeding fines. I laughed and told them that they were overreacting. Now I'm not so sure – if this criminal conviction, why not others?

The signs are already there, as another client incident showed me. One of their employees liked to tweet. The nature of Twitter is that there's no room for grey – opinions voiced there are generally black or white. And this person's Twitter timeline showed that he liked to tweet about the general political issues of the day. One of his readers took exception to some of his comments and contacted the firm – and the FCA. The firm acted swiftly to investigate and after a brief suspension as well as updating of the social media policy, re-instated the person. I advised them that this was the correct process, and that it was very unlikely that the FCA would be in touch with them.

You could have knocked me down with a proverbial feather when the client told me, only a few days later, that the FCA had indeed contacted the firm. Nothing aggressive; comments along the lines of was the firm aware, what action had been taken, etc. The firm was able to respond and the FCA reverted, saying that it had closed its file. All very well, but the fact that the regulator had resource deployed to engage with firms on the social media activity of employees was an eye-opener. Where does this stop? Do they do this in all cases where a member of the public complains to them about a tweet to which they've taken offence? Who is the regulator now? Your neighbour, taking exception to the way you're adhering to lockdown guidelines? What if they report you to the FCA? Anyone who doesn't like you?

Now, maybe I'm taking two and two and making 50. After all, this blurring of the line between private and public isn't happening everywhere. It was reported in *The Times* on 28 November that a £35,000 fine issued to a leading City solicitor who had drunken sex with a junior colleague had been overturned. Originally, a tribunal had ruled that he had breached professional rules by failing to act with integrity. So far, so much sounding like the FCA. But the High Court judges said that professional rules "may reach into private life only when conduct that is part of a person's private life realistically touches on [his/her] practise of the profession ... or the standing of the profession." The judges warned the legal watchdog that "regulators will do well to recognise that it is all too easy to be dogmatic without knowing it; popular outcry is not proof that a particular set of events gives rise to any matter falling within a regulator's remit."

The Times reported that in response to this ruling, the Solicitors Regulation Authority said it would "look at the judgment carefully before considering any next steps". Let's hope the FCA will do the same. But the wider point here is that the FCA's resource is spread too thinly. While relationship-managed/fixed portfolio firms may be supervised up to their eyeballs, the vast majority of firms are in a call centre relationship with the FCA Supervision Hub and largely unregulated – just like London Capital & Finance were. As long as these firms continue to enjoy this light touch regime, such scandals will recur. Would it be too much to ask for the FCA to divert staff from non-financial misconduct to firm supervision? Advocates of this agenda might say that to do so would damage the long-term health of the sector, and damage wider issues in society. Really? Ask the investors in LC&F what they would have preferred.

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