Regulatory risk in the UK

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Les régulateurs n'entament plus seulement des procédures pour sanctionner des entorses ou des infractions aux réglementations en vigueur. Au Royaume-Uni en particulier, la *Financial Services Authority* (FSA) adopte une attitude plus "holistique" dès lors qu'une infraction a été constatée. Dans sa pratique de l'investigation et de la sanction, elle s'attache autant aux procédures et aux méthodes de prévention utilisées pour gérer le risque réglementaire, qu'à la façon dont les entreprises mènent leurs affaires. Au-delà des personnes morales que sont les sociétés, les autorités de régulation s'intéressent également aux individus qui les composent, responsables *compliance* inclus.
Au cours des dernières années, sous l'influence grandissante de l'Europe et des États-Unis, le travail de régulation est devenu plus complexe. Les régulateurs se sont montrés plus proactifs dans le renforcement de leurs pouvoirs, et les entreprises ont en retour pris conscience de l'acuité du risque réglementaire.
La mission de la FSA a débuté suite à la mise en place de la *Financial Services and Markets Act 2000* (FSMA), et à la pléthore de directives européennes affectant l'industrie des services financiers.
En février 2005, DLA Piper Rudnick Gray Cary UK LLP a mené une étude portant sur les comportements des entreprises du FTSE 500 – et équivalentes – vis-à-vis des régulateurs et des réglementations. Les principaux décideurs en matière de réglementation ont participé à cette étude, intitulée "UK *Regulatory Awareness Survey*". Les principales conclusions font l'objet du présent article.

■ Regulators no longer simply take action in the event of specific regulatory breaches or infringements. Increasingly they intervene on the grounds that a company's regulatory procedures are inadequate. Regulators, and in particular the Financial Services Authority (FSA) are taking a more 'holistic' view, focusing as much on existing practices, ongoing prevention and the way in which a firm does business as they do on whether a breach has been committed. They are not only targeting companies, but also the individuals within them, including those who are responsible for compliance.

Regulation has become increasingly complex in recent years, partly due to greater influence from Europe and the US. Regulators have been more proactive in the enforcement of their powers and firms have, in turn, recognised the increased regulatory risk. The FSA has been active since the implementation of the Financial Services and Markets Act 2000 (FSMA) and as a result of the plethora of EU Directives affecting the financial services industry.

In February 2005, DLA Piper Rudnick Gray Cary UK LLP published a commissioned study into attitudes towards regulators and regulations from the perspective of senior regulatory decision makers within FTSE 500 and equivalent companies – UK Regulatory Awareness Survey. Selected findings are as follows:

Compliance

The FSA has been focussing on policy implementation (rather than development). This is borne out when one considers that only 18 Consultation Papers were issued by the FSA during 2004, when compared to 45 in the previous year. In contrast, 28 Policy Statements were issued, in which final implementation proposals have been set out

by the FSA on the matters on which it had consulted in 2003 and earlier in the year. These include implementation of the reform of the polarisation rules, introduction of the stakeholder product range (including Child Trust Funds), dealing with conflicts of interest in investment research and updating the entire insurance market. Implementation of these policies often falls to key personnel, including finance directors.

Many firms seem to be failing to ensure that their compliance procedures are up to the task of keeping the company – and its directors – within the law. Approximately three in ten firms regulated by the FSA do not have a financial services compliance programme. Given the complexity of financial regulations, and the ease with which firms can fall foul of them without realising it, some companies appear to be taking undue risk. Of those respondents with a compliance programme in place, a low proportion have tested it in the last six months and a greater proportion were not aware when it was last tested. Compliance programmes serve a useful purpose. If firms do find themselves subject to an investigation, having a compliance programme in place that has been regularly tested can be used as proof that the company has taken the regulatory issue seriously.

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Investigations - Powers

It is important for firms to understand what powers of investigation regulators have, if they are to be able to assess the risks they face and address them properly. The survey found that despite claiming to be aware of developments in regulatory law, most respondents exhibited a sketchy knowledge of the powers wielded by the regulators. For example, 88 % did not know that the FSA can use force to enter their premises in a raid (under a warrant) and 74 % were unaware that they have the right to remove documents during a search. Similarly, 75 % of respondents were unaware that the FSA can require individuals to answer questions in a compulsory interview.

Similar confusion is apparent in the area of punishments. For example, 82 % of respondents did not realise that the FSA has the right to seek a custodial sentence for certain breaches under FSMA. Less than a quarter of respondents knew that the FSA has the right to impose unlimited fines.

Impact on Business

The impact that an investigation and regulatory sanctions can have on a firm are profound and varied. Investigations are disruptive to business, have uncertain outcomes and can last a long time. Our research suggests that firms may underestimate the impact that an investigation has on the way their business is run and in particular how much time senior managers and finance directors may have to spend fire-fighting and dealing with investigative requests. Respondents feel less threatened by immediate monetary sanctions for breach of regulations than they do about effects such as damage to reputation, loss of trade, a fall in share price, or diversion of management focus. Although these latter effects primarily occur at the 'investigation' and not the 'sanction' stage, that is not always recognised by firms. The FSA is perceived as having the most damaging impact on business in the event of an investigation. 46 % of respondents felt that an investigation by the FSA would be 'damaging' or 'very damaging'.

The potential for a regulatory investigation to take up management time is clearly something that companies are aware of but perhaps do not fully appreciate. In the event of an investigation, management can become completely absorbed with producing information and feeding it to the investigators. When they are not, they are likely to be taking part in investigative meetings to make sure that they are compliant in all areas. The focus shifts from 'business' to 'compliance'. The next most feared consequence that is often overlooked is the damage that an investigation does to employee morale. The uncertainty created can unsettle employees and affect the quality of their work. Employees may well be called for interview as well as have to cope with onerous requests for documents, all under the pressure of potentially being cautioned or even arrested.

Prosecution

The FSA is considered to be the Regulator whose disciplinary action would have the biggest impact. Around three quarters (73 %) of respondents feel that disciplinary action by the FSA would be 'damaging' or 'very damaging'.

In spring 2004, there was a fundamental change in the FSA's approach to the regulation of listed companies when,

Good practices

Shortcomings	Action for improvement
Compliance : • No procedure • Outdated procedure • New requirements	• Monitor up and coming developments from the FSA • Seek advice from professionals and implement compliance procedures
• Investigations	• Prepare a raid / investigation procedure and embed in compliance procedures • Train all relevant staff including reception and security • Employ relevant professionals to assist with communications with the FSA and the media
• Prosecution / Enforcement Action	• Have fully embedded compliance procedures to provide evidence of good practice • Maintain communications and cooperate with the FSA • Employ experienced professionals to assist.

for the first time, the FSA used its powers to impose fines against individual company directors for their involvement in breaches of the Listing Rules. Geoffrey John Brown (Chief Executive Officer of Sportsworld Media Group Plc) and Martin Christopher Hynes (Chief Executive Officer of Universal Salvage Plc) both felt the brunt of the FSA's change in approach. The rulings highlighted the fact that directors of listed companies should take note that they are now quite clearly in the regulator's firing line.

There is no doubt that the FSA considered that the directors' actions fell short of the standards expected of them. In addition, the impact on both companies and their share prices was significant: the share price of Sportsworld collapsed and it went into administration and Universal Salvage's market capitalisation fell from £130 million to less than £30 million.

However more than financial ramifications, firms fear damage to reputation most of all. This is a point that Regulators have not been slow in recognising. Protection of reputation seems to motivate financial institutions, in particular, into paying up quickly and quietly when accused by the FSA. The FSA has stated publicly that one of their main weapons is to 'name and shame' companies. The fact that damage to reputation figures so highly in the list of concerns among our respondents suggests that companies do not fully appreciate that significant harm to reputation can occur at the investigation stage. If they did, their attitude toward investigations may be different.

Communication between companies and Regulators is vital to ensure a balanced and constructive relationship that can help both sides achieve their goals. This requires effort and an understanding of the complex issues and problems that each side faces. Even though the vast majority of firms believe they have a 'good' or 'very good' relationship with their Regulator, around a third believed that they would be investigated in the next year. Firms appear to be confident in their regulatory relationships but recognise that a good relationship is not enough to prevent them being investigated.

Advice

There is strong evidence that firms are now beginning to view the management of regulatory issues as a specialist discipline and are appointing their advisers accordingly. Three quarters of respondents would be 'fairly' or 'very likely' to turn to specialist regulatory lawyers when establishing compliance procedures. These figures indicate a significant shift in the business community. There is now a more widespread recognition that regulation is complex enough to require dedicated regulatory teams. Taking advice from lawyers who understand the intricacies of regulation and the advantages that can be gained from regulatory cooperation can improve greatly a firm's security and its relationship with its Regulator.

One factor to consider when explaining why firms turn to lawyers in an investigation is the protection provided by legal advice privilege. Lawyers have a duty to withhold from regulatory investigators documents that relate to the giving or receiving of legal advice. Similarly, companies may assert legal advice privilege in order to withhold such documents from review by Regulators. Legal advice privilege is strictly confined to communications between clients and lawyers who act in a professional capacity at the time when the relevant communication is made. It does not apply to notes and documents produced by, for example, accountants who investigate a client's business and then seek legal advice from lawyers. Regulators see advantages in dealing with companies that use lawyers. Andrew Procter, the FSA's former director of enforcement, has stated 'the great majority of lawyers that we deal with on investigations positively contribute to the effective resolution of the investigation'.

Finance Directors need to be aware of the importance not only of keeping current compliance processes in place, but of the preparatory work required to keep in touch with the FSA's plans on policy and enforcement. Being the subject of an investigation by the FSA can undermine a firm and cost a significant amount, long before any conclusions are reached as to wrongdoing. The negative publicity that such investigations can cause and the resultant damage to staff morale, shareholder confidence and corporate partnerships mean that dealing with the Regulator must be an ongoing process. Developments need to be monitored and a relationship built. Quick fixes, once an infringement has occurred, are no longer enough. ●

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