Regulators' approach to enforcement – an international comparison

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On 9 July 2019, the United Kingdom's Financial Conduct Authority (**FCA**) published its latest Enforcement annual performance report for the year 2018/19. This follows the publication of its final *FCA Mission: Approach to Enforcement* (**Statement**) in April 2019 after a consultation which ended in June 2018. In the Statement, the FCA acknowledges that "*increasingly, severe penalties and sanctions alone are not enough to reduce and prevent serious misconduct*" and that it "*must increase the likelihood of detection in tandem with efficient investigations*".

Taking the FCA's latest Enforcement annual performance report together with its Statement as an opportunity, our lawyers located in the UK, USA and Hong Kong have prepared this e-bulletin to compare how regulators in these jurisdictions approach enforcement.

United Kingdom – investigation as a diagnostic tool

The FCA's Director of Enforcement and Market Oversight, Mark Steward, joined the FCA after spending 9 years with the Hong Kong Securities and Futures Commission (**SFC**). We observe that the enforcement approach as set out in the Statement resembles the approach that Mark Steward adopted when he was with the SFC. In order to increase the likelihood of detection of wrongdoing by firms, the FCA has since Mark Steward 's arrival opened considerably more investigations in order to be perceived as "*always present*". In the last year alone, the FCA opened 343 enforcement investigations – the number of open investigations increased from 496 in March 2018 to 650 in March 2019 (an increase of 31%). The types of cases that have seen the biggest increase were in the areas of retail conduct, insider dealing and unauthorised business. The table below sets out the number of enforcement investigations that the FCA has opened since 2016.

	Mar 2016	**Mar 2017**	**Mar 2018**	**Mar 2019**
Number of open enforcement investigations	247	414	496	650

The Statement confirms that such strategy will continue although the FCA reiterates that the opening of an investigation does not mean that it believes misconduct has occurred or that anyone involved in the investigation is guilty of misconduct. The FCA confirms that it does

not pre-judge the outcome of an investigation, and the purpose of which is just to get a full understanding of the facts so that the FCA can make a decision about whether and, if so, what kind of action may be necessary. Our UK partner, Matthew Allen observes that "*rather than being solely a route to a public outcome, investigation is now being considered and used by the FCA as a diagnostic tool*".

While the above may have achieved the purpose of increasing the likelihood of detection, it is unclear in the Statement as to what steps the FCA is going to take to ensure investigations are conducted efficiently. For instance, unlike the position in the US and to some extent Hong Kong which are discussed below, the Statement does not set any target that the FCA will commit to with regard to the length of an investigation. In addition, the statistics relating to the time it is taking the FCA to conclude investigations appears to contradict the FCA's intention to be more strategic and efficient in its approach to enforcement. During the financial year 2018/19, the average length of concluded enforcement cases that resulted in an agreed settlement was 29.1 months, a significant increase from an average of 23.2 months in 2016/17 (albeit slightly lower than an average of 32.3 months in 2017/18).

In the circumstances, it seems that firms in the UK will continue to experience large numbers of investigations on major as well as minor infractions with no clear indication of how long such investigations will last.

United States – the Matter Under Inquiry (MUI) route

Federal financial regulators in the United States regularly issue similar enforcement policy statements in an effort to provide clarity to the industry and set priorities for future regulatory and enforcement activity. Our US partner, Lewis Wiener observes that "*unlike the prudential regulators of Hong Kong and the United Kingdom, the United States is home to a complex, multilayered federal and state financial regulatory regime – and therefore firms should be careful in charting their course through the US regulatory landscape*".

Here we focus on the Statement vis-à-vis the US federal financial regulators with arguably the broadest international reach and most aggressive enforcement stance historically – the U.S. Securities and Exchange Commission (**SEC**) and the Financial Industry Regulatory Authority (**FINRA**).

The SEC has in place two different forms of "investigations" – MUI and full investigation. The SEC may open an MUI if it is satisfied that the facts underlying the MUI show that there is a potential to address conduct that violates the federal securities laws (it will then have to further consider best use of resources). The Enforcement Manual of the SEC expressly states that the threshold for opening a MUI is "*relatively low*" and a MUI can be opened based on "*very limited information*". The investigators under a MUI will not have the full spectrum of investigative powers that they would otherwise have in a full investigation. In general, MUIs should be closed or converted to an investigation within 60 days.

On the contrary, an investigation generally should be opened after the SEC has done some additional information gathering, detailed evaluation and analysis of the matter. A key factor that the SEC will consider in deciding whether to open a full investigation is whether the case involves fraud and serious misconduct.

Both SEC and FINRA enforcement officials have stated publicly that they do not believe the number of investigations opened or formal actions brought by their organizations are a useful metric for evaluating the success of their respective enforcement programs. Both publish data related only to the number of enforcement or disciplinary actions brought formally (e.g. litigated in civil or administrative proceedings or settled through public orders or waivers), not the number of investigations opened or informal issues identified by examination staff.

It appears that the US regulators have taken a different approach to the one adopted by the FCA under the Statement in that we have not seen a surge in formal enforcement activity. Firms that are the subject of an MUI will generally see the matter closed or referred for formal investigation within a relatively short period of time.

Hong Kong – focus on high impact cases

Thomas Atkinson (who used to be with the Ontario Securities Commission) succeeded Mark Steward at the SFC to become its Executive Director of Enforcement. Under Thomas Atkinson's leadership, the SFC has (i) focused their resources on high impact cases, meaning it will devote more resources to transactions which appear to be oppressive or unfairly prejudicial to shareholders, or where fraud or other serious misconduct is suspected, and (ii) adopted a "front-loaded" approach, meaning it will intervene at an early stage in order to protect investors' interest and market integrity.

Our Hong Kong partner, John Siu observes that "*the SFC has, in a way, gone completely opposite to the FCA's approach – it is now focusing on issuing big-ticket fines in order to send a strong deterrent message to the market in the hope that everyone would raise their game to ensure compliance*".

The SFC's enforcement approach is reflected in the enhanced level of penalties and the reduced number of investigations.

In terms of the level of penalties, firms subject to disciplinary proceedings by the SFC would in the past expect a fine of no more than HK$10 million (about GBP1 million, or US$1.2 million). However, consistent with the policy to focus on high impact cases, the SFC has recently imposed a record-breaking fine of over HK$800 million (about GBP80 million or US$102 million) against a total of 5 firms for various sponsor failures.

In terms of the number of investigations started by the SFC, the figure has dropped significantly since 2015. Please refer to the table below for more details.

	2015/16	2016/17	2017/18	2018/19
Number of investigations started	515	414	280	238

Given the focus is now on high impact cases which would by their nature be more complex and difficult to investigate, the SFC has since 2017 stopped referring to their self-imposed target of completing most of their investigations within seven months (which was set by the SFC back in 2008). Statistics available prior to the change show that the percentage of investigations which the SFC were able to complete within seven months had reduced from 70% in 2014/15, to 51% in 2015/16 and down to 46% in 2016/17. After 2017, there is no available information about the length of time that the SFC took in completing investigations.

It appears that the industry as a whole is experiencing a smaller number of investigations by the SFC. But in the event that one is started, chances are that it will last longer (at least seven months) and that a hefty penalty is more likely than before.

Conclusions

The difference in the enforcement approach can have a profound impact on whether the regulator will start an investigation and how such investigation will be conducted. Firms with multijurisdictional presence should pay heed to the difference enforcement approaches and monitor their development. When facing an investigation, firms should engage external counsel with local expertise across jurisdictions.