UK financial watchdog's enforcement problems, regulatory failures detailed by audit body

8 Dec 2023 | 00:01 GMT | **Insight**
By Jakub Krupa and Abhishek Kumar

The UK financial services regulator sees “significant delays” between identifying a problem and enforcement as it is changing in the wake of "regulatory failures" and adapting to a new post-Brexit regulatory landscape, according to a new report from the UK's public spending watchdog, the National Audit Office.

The UK financial services regulator sees “significant delays” between identifying a problem and enforcement as it is changing in the wake of "regulatory failures" and adapting to a new post-Brexit regulatory landscape, according to a new report from the UK's public spending watchdog.

The National Audit Office looked at how the Financial Conduct Authority was “responding to changes in its regulatory powers and remit and wider developments in the financial services sector,” including the rise of new products and technologies — such as cryptoassets and artificial intelligence — which pose further compliance questions (see here).

The FCA, which regulates approximately 50,000 firms in a 175 billion-pound ($220 billion) industry, was also given new powers after Britain’s withdrawal from the EU, including in the Financial Services and Markets Act, adopted last year (see here and here).

As part of the reform, the FCA is legally required to consider the impact of its rules on the UK’s international growth and competitiveness as a secondary objective in its regulatory process. The goal has been controversial and subject to pushback (see here)

— Organization in transition —

The NAO's audit found that despite making changes and spending more than 317 million pounds in its transformation, the FCA was still in transition as it adapted to new challenges by rethinking its enforcement approach, reviewing data management policies and looking into staffing problems.

The regulator drew fire for what the auditors called “high-profile issues” and “regulatory failures,” such as the collapse of London Capital and Finance in 2019 (see here), which prompted stark criticism of the regulator (see here), and the liquidation of the Connaught Income Fund.

In response to an independent review of its actions, the FCA said in 2020 that it would join up its policy, supervision, and competition functions under two new executive directors to “have a better approach to translating insights into risks and warnings” (see here).

The audit office said that due to this process, the regulator faces unusual uncertainty as it is “attempting a significant amount of change, on a number of fronts, all at the same time. This brings risks.”

One of the prioritized areas, the management of data, may need “years to complete,” it said, pointing out that some companies complain about “the volume, relevancy and use of the data” collected through over 200 compliance reports with 720,000 data items, warning about the perceived amount of red tape and “the impact these requests have on firms.”

— Enforcement and new powers needed —

The watchdog also pointed out that “there can be a significant delay between the FCA identifying an issue to tackle and it taking regulatory action.”

Even if an issue is within its remit, the FCA can take years to take action, the NAO pointed out: It cited the example of the regulator waiting for three years to move from engaging with illegal cryptoasset companies and requiring them to comply with money-laundering regulations in 2020 to enforcement this year (see here).

In other cases, the FCA often needs additional powers that require legislation — as in the case of "buy now, pay later" credit providers (see here and here) — with limited powers under different laws in the meantime (see here).

The regulator also finds itself often in a situation where it needs to give companies operating under temporary regimes additional time to adapt to changes.

— Staffing issues —

The NAO also pointed to “disruptive” levels of staff turnover, including at senior levels, with “high” delivery risks in some areas.

It cited the crypto sector again: “For example, a shortage of crypto skills meant the FCA took longer than planned to register cryptoasset firms under money laundering regulations,” it said, explaining that the regulator struggled with more applications than expected and could not process them in time.

Echoing similar concerns expressed recently by the chair of the Competition and Markets Authority (see here), the audit body said the FCA “found recruitment and retention of staff with crypto compliance skills … difficult due to competition between employers for people with these skills.”

The NAO also stressed that as many as ten out of 11 most senior executives have been appointed only over the last three years, with seven of them coming into the regulator from outside.

Separately, the FCA was also told to reform its “complex” public reporting, which “makes it difficult for stakeholders to judge its performance,” with little clarity on tangible milestones and targets.

Please e-mail editors@mlex.com to contact the editorial staff regarding this story, or to submit the names of lawyers and advisers.

Related Portfolio(s):
Financial Services - Regulation - Financial Services and Markets Bill (UK)
Financial Services - Regulation - FCA introduces consumer-duty policy (UK)

Areas of Interest: Sector Regulation

Industries: Banking & Finance, Banking Institutions & Systems, Banking, Lending & Credit Services, Financial Market Updates, Financial Markets & Investing, Payment Cards & Services, Retail Banking

Geographies: Europe, Northern Europe, United Kingdom

Topics:

Bank capital | Bank governance | Bank supervision | Consumer credit | Cryptoassets