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REPORT HIGHLIGHTS

Trends in Regulatory Enforcement in UK Financial Markets 2015/16 Year-End Report

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In this annual report, we undertake a detailed analysis of recent enforcement activity by the Financial Conduct Authority (FCA). NERA maintains a proprietary database of fines and other enforcement activity by the FCA, allowing us to pinpoint trends that are not necessarily visible when reviewing individual cases. We provide a snapshot of the report's most significant findings below.

2015/16 Trends Summary

A Swing Back to Lighter Enforcement Against Firms?

The number of fines that the FCA imposed on both firms and individuals in 2015/16 was **lower than in the prior four financial years**.

After an unprecedented £1.4 billion in fines in the 2014/15 financial year, £794.3 million in fines were issued in the first half of 2015/16, a similar pace to 2014/15. However, in the second half of the 2015/16 financial year, **fine amounts dropped markedly**, to less than £100 million.

Large fines against firms for manipulation of interbank or FX rates have largely worked their way through the FCA enforcement pipeline. However, the substantial drop in fine amounts in the second half of the 2015/16 financial year is not solely attributable to the absence of these fines.

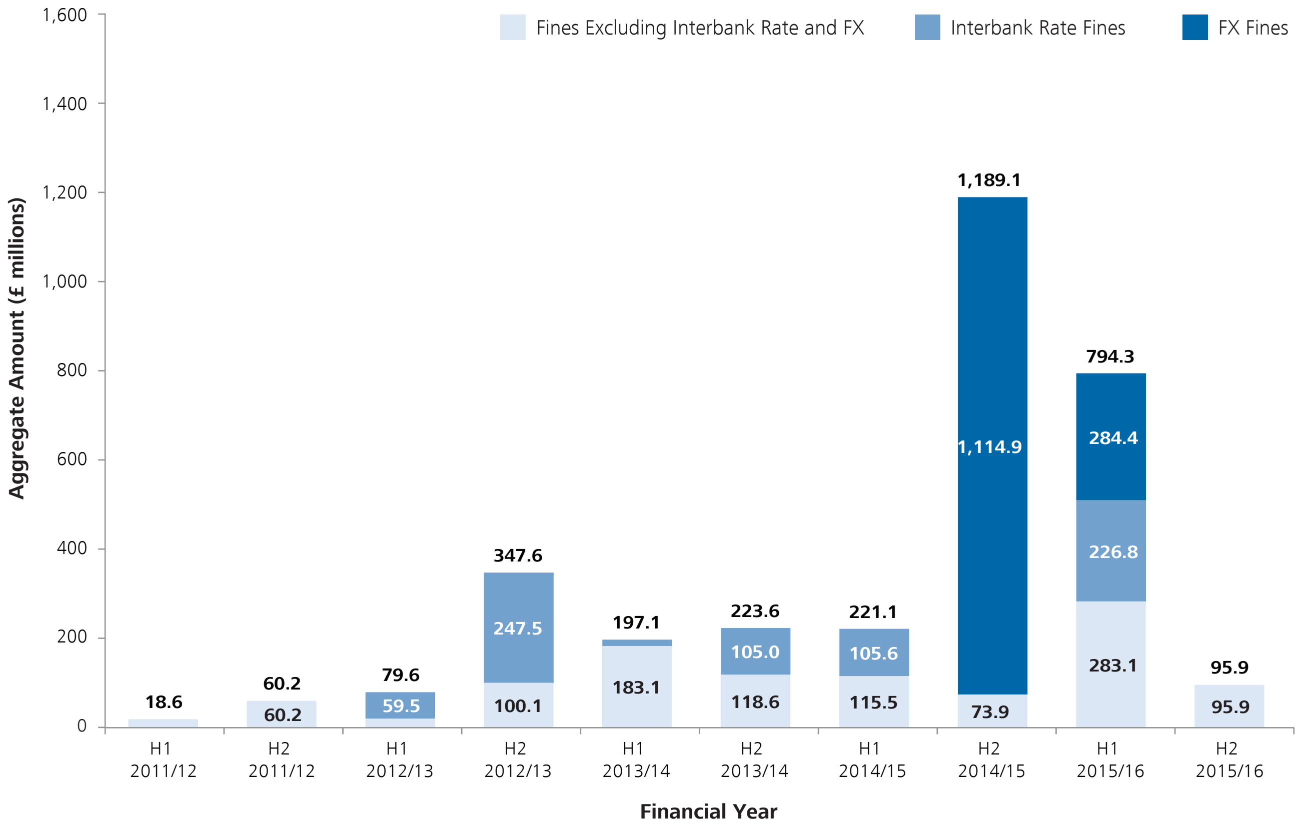
Enforcement Against Individuals Potentially on the Rise

FCA enforcement against individuals has remained at a low level. However, the number of fines against individuals in the second half of the 2015/16 financial year was **double** that in the first half of the year.

In fact, the majority of fines in the second half of the year were against individuals, including the **largest ever FCA fine against an individual** of £14.2 million.

In addition, the Senior Managers Regime (SMR), which came into force in March 2016, and the EU Market Abuse Regulation (MAR), which came into force on 3 July 2016, may lead to increased enforcement activity by the FCA against individuals going forward.

Semi-Annual Aggregate FCA Fine Amounts Against Both Firms and Individuals



Looking Ahead

The FCA's Top Enforcement Priorities

The FCA's Business Plan for the 2016/17 financial year identified seven priority themes, which will form the primary focus of the regulator's discretionary work and which provide some insight into potential future areas of enforcement. These are:

- Pensions
- Financial crime and anti-money laundering
- Wholesale financial markets
- Investment advice
- Innovation and technology
- Firms' culture and governance
- Treatment of existing customers

Two of these priority themes (wholesale financial markets and investment advice) are new in 2016/17, whereas the rest were also stated priorities for the 2015/16 financial year.

Developments in the Broader Economy and in Financial Markets

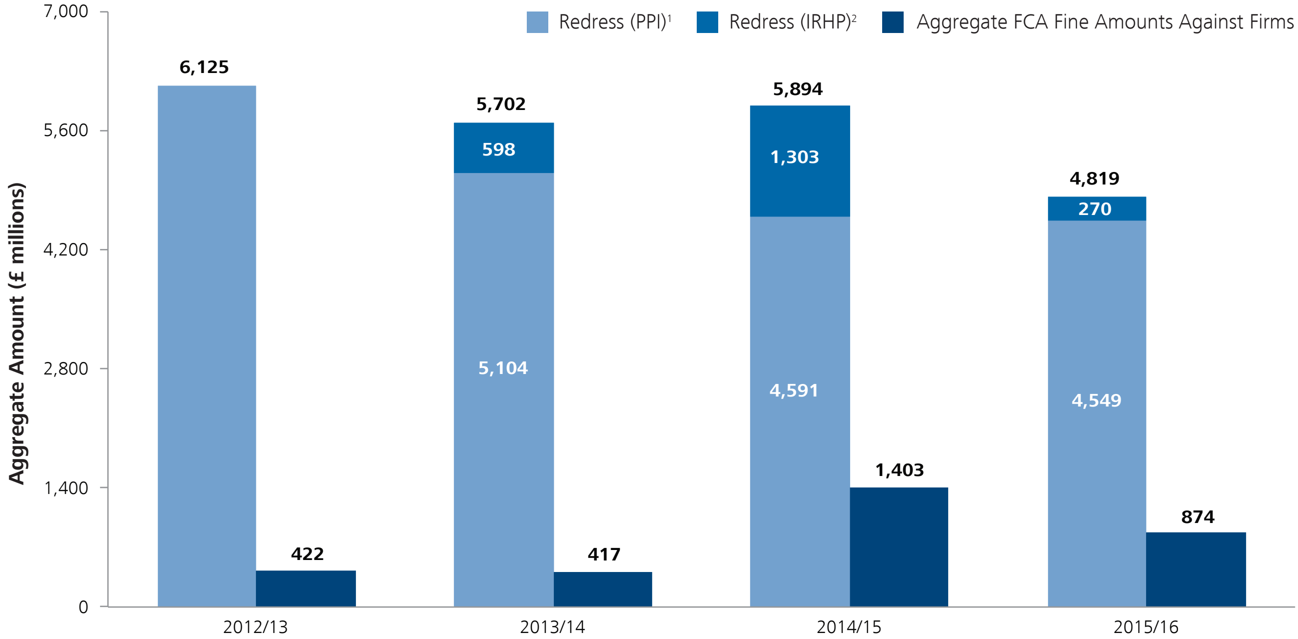
In addition to the FCA's stated priorities, the focus of enforcement inevitably is also driven by developments affecting the broader economy and financial markets. The FCA has expressed concern that slowing economic growth may result in risks to financial consumers and to the integrity of the financial markets.

Even if regulators succeed in reducing the risks of misconduct relating to traditional financial institutions and products, the possibility remains that such risks may simply migrate to new markets, products, and institutions. **High-frequency trading, alternative payment systems, and peer-to-peer lending** are technological and market innovations that may raise enforcement issues in future.

Putting Fines In Context: Total Conduct Costs

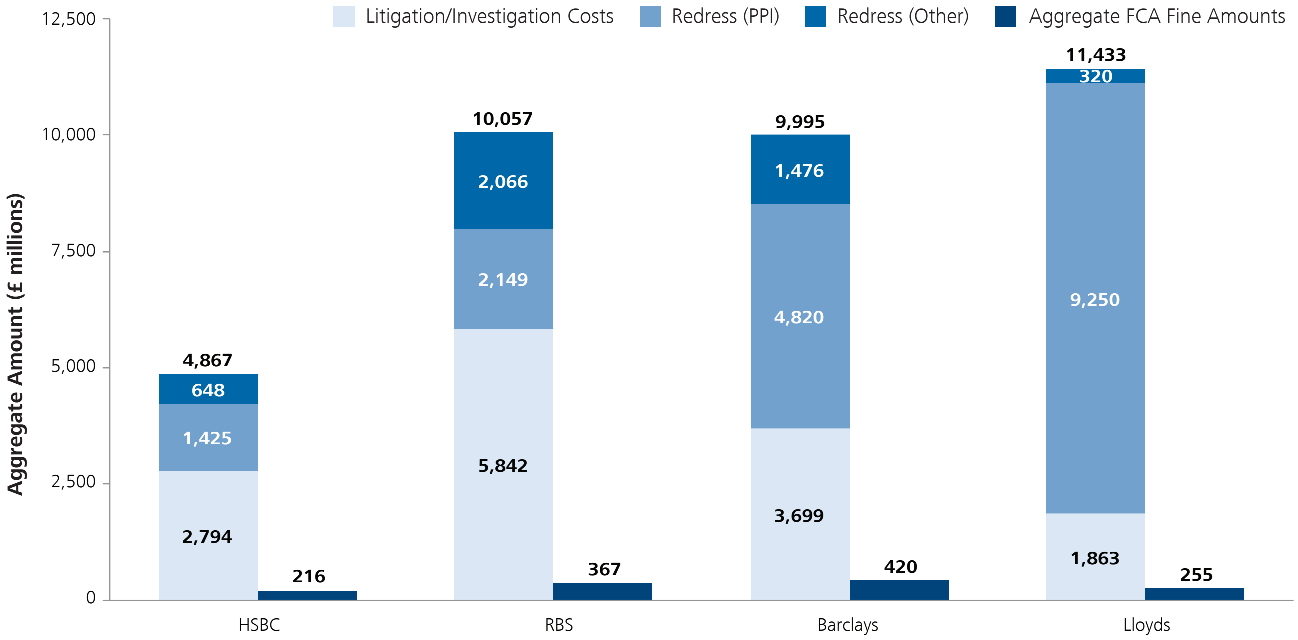
Although fines imposed against UK firms in recent years have been substantial, **these amounts have been far exceeded by other conduct-related costs**, including FCA-mandated redress to customers and the cost of enforcement, investigations, and legal disputes across multiple jurisdictions. Moreover, these conduct costs do not reflect reputational damage that an enforcement action may inflict on a firm.

Annual FCA Redress Paid for Payment Protection Insurance (PPI) and Interest Rate Hedging Products (IRHP) Compared with Aggregate Fine Amounts Against Firms for All Conduct



Notes and Sources:
1 Data are from the FCA. See Monthly PPI Refunds and Compensation, Financial Conduct Authority, 14 March 2016.
2 Data are from the FCA. See Interest Rate Hedging Products, Financial Conduct Authority.

Conduct Cost Provisions Taken by Four of the Largest UK Banks and Total FCA Fine Amounts Imposed on the Same Banks
1 January 2013 – 31 December 2015



Notes and Sources:
Data are from company annual reports (HSBC Holdings Plc, Royal Bank of Scotland Group [RBS], Barclays Plc, and Lloyds Banking Group).

In addition, academic researchers have recently sought to quantify the **reputational damage** associated with enforcement actions and suggest that such harm often substantially exceeds the size of the fine itself. A forthcoming paper by Armour et al. finds that, from January 2001 to January 2011, when the FCA announced fines on publicly traded firms, the average drop in market value for certain categories of fines was **nine times** the size of the fine and other payments such as redress. Armour et al. attribute this additional market value loss to the reputational effect of the fines announced.

Brexit

The recent referendum result in the UK to exit the EU (Brexit) creates some uncertainty in the longer term with respect to both economic performance and the future evolution of the regulatory and legal framework within which the FCA operates. NERA will continue to monitor and analyse these developments as they unfold.

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