ALLEN & OVERY

FCA proposes to take enforcement action against an individual relating to "non-financial misconduct"

Background

In order for an individual to be approved by the FCA and/or the PRA to perform one or more Senior Management Functions (**SMFs**) for the purposes of the Senior Managers Regime, their firm, as well as the FCA and/or the PRA, must be satisfied that they are fit and proper to perform the relevant SMFs (sections 60A(1) and 61 of the Financial Services and Markets Act 2000 (**FSMA**)).

After an individual is approved by the FCA and/or the PRA to perform one or more SMFs, their firm must continue to assess their fitness and propriety to perform their role on an ongoing basis and notify the FCA and/or the PRA if they believe that an individual is no longer fit and proper to perform their role. In addition, the FCA and/or the PRA may withdraw their approval for an individual to perform one or more SMFs at any point (section 63 FSMA) and/or prohibit an individual from performing any SMFs in relation to regulated activity (section 59 FSMA) if it considers they are no longer fit and proper to do so. The FCA's Enforcement Guide (**EG**) sets out the FCA's policy on withdrawing SMF approvals and issuing prohibition orders. At a high level, the FCA will consider whether taking such action will assist in achieving its statutory objectives. The FCA will also consider "all the relevant circumstances" of the case, with reference to a non-exhaustive list of circumstances (EG 9.3.2).

The FCA and the PRA have identified the following criteria (the **FIT test**) as being relevant to an individual's fitness and propriety:

– Honesty, integrity and reputation.

– Competence and capability.

– Financial soundness.

(FCA Handbook, FIT 1.3.1BG; PRA Rulebook, Fitness and Propriety Part, section 2).

An individual need only be deemed lacking in one of these areas to be assessed as not fit and proper.

The FCA's non-exhaustive guidance relating to its fitness and propriety criteria does not expressly refer to non-financial misconduct. However, it does include whether an individual has been convicted of a criminal offence (in particular, offences of dishonesty, fraud, financial crime, market manipulation and insider dealing, or offences under certain company and business legislation) as a factor that may be relevant to their fitness and propriety (FIT 2.1.3G). The FCA has said that the fact that an individual has been convicted of a criminal offence will not automatically mean that an individual is not fit and proper. Instead, each situation will be considered "*on a case-by-case basis, taking into account the seriousness of, and circumstances surrounding, the offence, the explanation offered by the convicted person, the relevance of the offence to the [individual's] role, the passage of time since the offence was committed and evidence of the individual's rehabilitation*" (FIT 2.1.1G).

Facts

Mr Frensham is a financial adviser and the sole director of a financial advisory firm (the **Firm**). He is approved by the FCA to perform the following SMFs: SMF3 (Executive Director), SMF16 (Compliance Oversight) and SMF17 (Money Laundering Reporting Officer).

In 2017, and while he was approved by the FCA to perform various controlled functions under the Approved Persons Regime (the predecessor to the Senior Managers Regime), Mr Frensham was convicted of attempting to meet a child following sexual grooming contrary to section 1(1) of the Criminal Attempts Act 1981. Mr Frensham was sentenced to 22 months' imprisonment, suspended for 18 months. An indefinite Sexual Harm Prevention Order was imposed on Mr Frensham and his name will appear on the Sex Offenders Register until 2027.

Proposed enforcement action

The FCA has issued a decision notice to Mr Frensham which, in light of his criminal conviction, proposes to withdraw its approval for Mr Frensham to perform his SMFs and also proposes prohibiting him from performing any function in relation to regulated activity in the future.

The basis for the FCA's proposed enforcement action against Mr Frensham is that the FCA considers that Mr Frensham's criminal conviction and the circumstances surrounding it demonstrate that he lacks the necessary integrity and reputation to be assessed as fit and proper and that he therefore poses a risk to consumers and to public confidence in the financial system.

Referral to the Upper Tribunal and privacy application

Mr Frensham has referred the decision notice to the Upper Tribunal. Following a hearing, the Upper Tribunal has the power to either dismiss Mr Frensham's reference or remit the matter to the FCA with a direction to reconsider and reach a decision in accordance with the Upper Tribunal's findings if it is not satisfied that the FCA's proposed decision falls within the range of reasonable decisions (section 133(6) FSMA). The FCA's proposed action outlined in the decision notice is therefore provisional and has no effect pending determination by the Upper Tribunal.

Mr Frensham unsuccessfully applied to the Upper Tribunal for a privacy order, which would have prevented the FCA from publishing its decision notice or releasing any details about its proposed enforcement action against Mr Frensham pending the Upper Tribunal's hearing of his reference. In particular, the Upper Tribunal was not convinced that the likely financial consequences of the FCA publishing the decision notice were sufficient to cause a *"significant likelihood of damage to Mr Frensham's livelihood which is so severe that it is out of proportion to the public interest in the principle of open justice that [would] be served by permitting publication of the Decision Notice"* (paragraph 68). The Upper Tribunal also noted the *"very high hurdle"* that Mr Frensham faced in seeking to establish it would be unfair to permit publication of the decision notice (paragraph 68).

Decision insight

This is the fourth case relating to non-financial misconduct that the FCA has publicised since November 2020. All four cases have focused on the impact that conduct outside of the workplace (namely convictions for serious criminal offences) have on individuals' fitness and propriety and, specifically, their integrity and reputation.

Unlike the other three cases concluded by the FCA in November 2020, Mr Frensham referred the FCA's proposed enforcement action against him to the Regulatory Decisions Committee (the **RDC**). Mr Frensham's representations before the RDC and the RDC's response to them are set out in the decision notice. This information provides us with a much more detailed insight into how the FCA approached and reached its proposed decision that Mr Frensham is not fit and proper, as well as how the RDC responded to various points that Mr Frensham argued in his defence.

We have highlighted below some of the key points from these parts of the decision notice that are likely to be of broader application.

When it is handed down, the Upper Tribunal's judgment in this case will shape the FCA's future approach to taking enforcement action against individuals in relation to non-financial misconduct, and specifically non-financial misconduct that occurs outside of the workplace in individuals' private lives. The Upper Tribunal's judgment is also likely to be instructive for regulated firms in terms of the factors they should consider when assessing the potential regulatory impact of non-financial misconduct that comes to their attention. In particular, we anticipate the Upper Tribunal will explore in more detail the meaning of "integrity" and "reputation" in the context of non-financial misconduct for the purposes of fitness and propriety standards.

The FCA's approach to assessing the impact of non-financial misconduct on fitness and propriety

The FCA uses the term "non-financial misconduct" to cover a range of misconduct, which extends well beyond actual or attempted sexual misconduct. For example, the FCA has referred to bullying, harassment, discrimination, favouritism, exclusion and intimidation when talking publicly about non-financial misconduct.

The FCA has been very vocal about its focus on tackling non-financial misconduct in the financial services industry, as well as its expectations of firms in this area. These expectations include firms taking steps to mitigate the risk of non-financial misconduct arising in the workplace in the first place, as well as firms taking appropriate steps to handle instances of non-financial misconduct when they arise. When instances of non-financial misconduct are identified, firms are expected to consider whether this misconduct may amount to a breach of the FCA and/or PRA Codes of Conduct and, in the case of Senior Managers and Certified Persons, whether the misconduct may impact their ongoing fitness and propriety to perform their roles.

Consistent with its approach to the three enforcement cases that were concluded in November 2020, the FCA considered the following five factors when assessing what, if any, impact Mr Frensham's criminal conviction and the conduct that gave rise to it may have on his fitness and propriety:

– The seriousness of the individual's conduct and the circumstances surrounding the relevant conduct.

– The relevance of the conduct to the individual's role in a financial services firm and/or the financial services industry more widely.

– The individual's explanation for their conduct and the passage of time since the conduct in question.

– Whether there is any evidence of rehabilitation and/or a change in behaviour on the part of the individual.

– The severity of the risk posed by the individual to consumers and to confidence in the UK financial system.

Firms should incorporate these factors when they are assessing the potential regulatory implications of an individual's non-financial misconduct, regardless of whether it occurred in or outside of the workplace.

The FCA's approach to assessing fitness and propriety applied in practice

Mr Frensham put forward a number of arguments as to why the FCA should not impose a prohibition order on him. Even though the RDC rejected these arguments, they provide an insight into how the FCA considered the five factors above and determined it should impose a prohibition order on Mr Frensham in light of his criminal conviction. Importantly, the FCA confirmed in the decision notice that these factors *"need to be considered on a case-by-case basis and do not need to be given equal weight"*. In this case, the FCA determined that it was *"appropriate to give most weight to the seriousness of Mr Frensham's offence, which involved exploitation, an abuse of a position of trust and a deliberate and criminal disregard for appropriate standards of behaviour".*

Considering an individual's integrity "in the round"

Mr Frensham argued that the FCA had wrongly applied the FIT test by focusing solely on his criminal conviction, as opposed to having regard to *"all relevant matters"* relating to his integrity. Although Mr Frensham seemed to acknowledge that the serious nature of his criminal offence and the actions that gave rise to it lacked integrity, he argued that the actions that took place *"over a short period of time in 2016 [do] not mean that in 2020 he is a person who lacks integrity".* He also noted that his integrity *"must be considered in the round, having regard to the totality of the evidence"* while describing a criminal conviction as *"a snapshot of a person's integrity and should not be relied on as the sole determining factor in understanding their whole character".* In support of his representations on this point, Mr Frensham provided *"character references and testimonials from clients and a family member who had full knowledge of his conviction".*

The RDC rejected Mr Frensham's arguments and did not accept it had wrongly applied the FIT test. The RDC attached significant weight to the seriousness of Mr Frensham's criminal conviction and noted that, although Mr Frensham has since expressed remorse and regret for his actions, the sentencing judge commented that he showed no remorse at the time about the actions that led to his conviction. Mr Frensham had explained that, at the time he committed his criminal offence, he was under *"serious strain in his personal life and he was under arrest for a separate crime which he knew he had not committed and for which he was never charged".* The RDC dismissed these points and decided they did not mitigate the seriousness of Mr Frensham's conduct or give the FCA confidence that he poses little or no risk to consumers. Instead, the RDC found that Mr Frensham's criminal conviction was aggravated by certain circumstances, namely that at the time he committed the offence he was the sole approved person working for the Firm, provided financial advice to potentially vulnerable customers and, by committing the offence, was in breach of bail conditions he was subject to as part of an investigation into a separate matter.

The RDC had regard to the character references and testimonials that had been provided by three of Mr Frensham's clients, but considered it was *"not appropriate to place too much weight on this limited evidence in reaching conclusions regarding the wider public interest which is not confined to Mr Frensham's clients".* The RDC also placed *"limited weight"* on the character reference provided by Mr Frensham's family member, given their personal and financial connection to Mr Frensham and the Firm. However, in cases not involving criminal convictions or where such evidence may be more persuasive, it is possible the FCA may attach more weight to character references and testimonials provided by third parties.

Overall, the RDC concluded that: *"the serious nature of [Mr Frensham's] offence and its surrounding circumstances must be given much greater weight and that in all the circumstances the only reasonable conclusion it can reach is that Mr Frensham lacks integrity".*

Considering the impact of an individual's conduct on their reputation

The FCA expressed concerns that, if Mr Frensham were allowed to continue operating as a financial adviser, this could cause a risk to consumers, damage to the Firm's reputation and damage to the public's trust in financial services more generally. Mr Frensham described these concerns as *"speculative"* in his representations before the RDC. Although he acknowledged that following his criminal conviction he had changed his name and the Firm's name, he argued there was no evidence to suggest that him continuing his role as a financial adviser had caused reputational damage to the Firm or to the financial services industry. Rather, he argued that imposing a prohibition order on him would harm the Firm and the reputation of the financial services industry due to the negative impact this would have on his clients.

The RDC rejected these arguments. It pointed to the *"negative publicity"* that Mr Frensham received following his conviction and described Mr Frensham's decision to change his name and the name of the Firm as evidence that he attempted to *"distance himself from the negative public reaction to his own behaviour and conviction which would doubtless have had a detrimental impact upon his livelihood".* The RDC stated that it *"considers there is a risk of erosion of public confidence if individuals who have committed such misconduct and do not have the requisite reputation are permitted to continue working in the financial services industry".*

The RDC pointed to the fact that *"about one third of Mr Frensham's clients chose to leave [the Firm] following his conviction"* as evidence that *"strongly suggests that, due to his reputation, many consumers had and would have concerns with him acting as their financial adviser".* Even though Mr Frensham had pointed to the fact that two thirds of his clients had remained with the Firm following his conviction, the FCA noted that he did not proactively inform clients of his conviction and that *"he would confirm the fact of his conviction [only] when prompted by clients".* The RDC noted that Mr Frensham's conviction might not come to the attention of new clients if it was not mentioned by him, especially as Mr Frensham had changed his name and the Firm's name following his conviction, meaning that *"there is a risk that new clients will not be in a position to make an informed decision about whether to instruct him"* to act as their financial adviser.

Impact of other punishments already imposed on an individual

Mr Frensham pointed to the fact that he had already been punished by the criminal justice system for his criminal offence and that it was not therefore necessary for the FCA to also impose a prohibition order on him. He received a suspended custodial sentence, is subject to an indefinite Sexual Harm Prevention Order (which, among other things, restricts his use of electronic devices unless he notifies the police and allows them access for inspection) and his name will appear on the Sex Offenders Register until 2027. Mr Frensham also argued that the FCA *"would be curtailing [his] path to rehabilitation"* if it imposed a prohibition order on him.

The RDC applied a different interpretation to Mr Frensham's prior punishments. In particular, it highlighted Mr Frensham's indefinite Sexual Harm Prevention Order and the fact that he will remain on the Sex Offenders Register until 2027 as indicating *"that the criminal justice system deems that he will remain a risk to others for some considerable time in the future"* and that these restrictions had been imposed on Mr Frensham *"because there is an ongoing risk to be managed".* The RDC described these points as a *"significant barrier to concluding that [Mr Frensham] has the requisite integrity and reputation for the purposes of [the] FIT [test]".*

The passage of time since the misconduct occurred

Mr Frensham noted that, although the FCA was aware of his events leading to his criminal conviction in 2016 as well as the conviction itself in 2017, it did not take any steps against him then, or even contact him again about the matter until January 2019. He described this *"lack of urgency on the part of the [FCA] in taking action"* as *"undermin[ing] the need for a prohibition order".* In addition, Mr Frensham noted that over three and a half years had elapsed since his actions that led to the conviction during which time he had continued to act as a financial adviser without any criticisms being made of him or his advice to clients.

The RDC expressly acknowledged that the FCA *"could have taken action to prohibit Mr Frensham sooner, but considers that this is not relevant to the question of whether he is fit and proper and poses a risk to consumers and confidence in the financial system".* The RDC also acknowledged that while *"no criticism has been made of Mr Frensham's behaviour since his conviction"* this did not equate to Mr Frensham being *"fully rehabilitated, such that he no longer presents a risk to consumers or to confidence in the financial system, especially given the seriousness of his offending"* and that *"the passage of time since [his] conviction is not sufficient to assuage [the FCA's] concerns relating to Mr Frensham's offending and surrounding circumstances".*

As is explained above, the FCA has expressly stated that the passage of time since misconduct occurred is a factor that they will consider when determining what, if any, impact that misconduct has on an individual's fitness and propriety. However, this is a clear example of how the FCA will weigh this factor against others in order to reach a decision on an individual's fitness and propriety, namely, in this case, the severity and the surrounding circumstances of an individual's misconduct.

Aggravating factor: openness and transparency

In his representations before the RDC, Mr Frensham argued that the fact that he had informed the FCA about his criminal conviction supported his arguments as to why the FCA should not impose a prohibition order on him. In addition, Mr Frensham highlighted before the RDC that he had *"never been the subject of a complaint, investigation or disciplinary procedure by the [FCA], Chartered Insurance Institute… or Financial Services Ombudsman, or any other professional body".*

The RDC disagreed with Mr Frensham's interpretation of these points, noting that it did not consider that Mr Frensham had been *"open and transparent"* with the FCA *"on a number of occasions, as he was required to be".* For example, the RDC noted that Mr Frensham failed to notify the FCA about:

– His earlier arrest in respect of a separate matter that led to the imposition of bail conditions.

– His arrest in respect of the offence that led to his criminal conviction.

– The fact that, while on remand pending trial for five weeks, he was not in a position to discharge his controlled functions or ensure compliance by his firm with its regulatory obligations and so had arranged for locum cover.

– The Chartered Insurance Institute's refusal to renew his Statement of Professional Standing.

– The Chartered Insurance Institute's subsequent decision to expel him from its membership.

Even though it appears that the RDC would not have reached a different decision in the absence of these points, the RDC interpreted them as aggravating factors that *"undermine[d] Mr Frensham's submission that he is a person of integrity".*

Beckwith judgment and potential implications for fitness and propriety assessments involving conduct that takes place outside of the workplace

The FCA and the PRA have both been clear that assessments of fitness and propriety (regardless of whether they are undertaken by them or by firms) should be focused on whether an individual is fit and proper to perform their specific role for their regulated firm. This is a theme that ran throughout Mr Frensham's representations before the RDC, that is, that his criminal conviction should not result in him being assessed as not fit and proper to continue performing his role as a financial adviser for the Firm.

The recent High Court judgment in Beckwith v Solicitors Regulation Authority [2020] EWHC 3231 (Admin) has prompted some discussion about how assessments of fitness and propriety relating to non-financial misconduct that takes place outside of the workplace in an individual's private life should be undertaken in the financial services industry.

While Beckwith concerned the conduct of a solicitor and subsequent disciplinary action taken against them by the Solicitors Regulation Authority, the High Court made the following comment about the impact that events that take place in an individual's private life may have on their professional standing:

> *"[The applicable rules] may reach into private life only when conduct that is part of a person's private life realistically touches on [their] practise of the profession… or the standing of the profession... Any such conduct must be qualitatively relevant… 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"* (paragraph 54).

Mr Frensham unsuccessfully argued before the RDC that, although a serious matter, his criminal conviction did not impact his fitness and propriety to perform his role as a financial adviser at the Firm. In particular, he argued that his:

> *"conviction has no bearing upon, and is irrelevant to, his competence as a financial adviser… there is no real risk of his integrity being called into question in any way which is relevant to his professional work. His criminal offence did not involve financial dishonesty and is not amongst [the criminal] offences to which the Authority [has said it] will give particular consideration in considering a person's fitness and propriety".*

The FCA disagreed with this argument. The FCA pointed to Mr Frensham's role as a financial adviser *"in a position of trust as regards his customers, who rely on his advice when making significant financial decisions and need to be able to trust that he will act appropriately"* and also explained that "*in order to maintain public confidence in the financial services industry, the [FCA] and the public are entitled to expect that approved persons and financial advisers are individuals with integrity and good reputation".* Even though Mr Frensham's offence was not committed at work and did not involve financial dishonesty, the FCA found that it did involve him *"deviating from legal and ethical standards and seeking to exploit those more vulnerable than himself, which in the [FCA's] view is fundamentally incompatible with his role as a financial adviser".*

The FCA's decision notice was issued prior to the publication of the *Beckwith* judgment (the steps described above that Mr Frensham took to try and prevent the FCA from publishing the decision notice delayed its publication by several months). As a result, Mr Frensham's representations before the RDC and the RDC's response to them did not refer to *Beckwith*.

It is possible that the Upper Tribunal will consider and refer to *Beckwith* when it turns to consider Mr Frensham's reference and, in doing so, provide clarity about the circumstances in which non-financial misconduct that occurs outside of the workplace in an individual's private life may have an impact on their fitness and propriety to perform a specific role for a regulated firm.

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Source

– FCA decision notice issued to Jon Frensham (dated 1 October 2020, published 29 March 2021) and FCA press release (published 29 March 2021).

– Upper Tribunal (Tax and Chancery Chamber) judgment regarding privacy application: Jon Frensham v The Financial Conduct Authority [2021] UKUT 0083 (TCC) (dated 24 February 2021, published 1 April 2021).

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