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FINANCIAL REGULATORY INVESTIGATIONS AND DISPUTES

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HOT TOPIC

FINANCIAL REGULATORY INVESTIGATIONS AND DISPUTES



PANEL EXPERTS

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Jill Lorimer is a partner in Kingsley Napley's financial services group and has an extensive track record in advising firms and individuals facing regulatory and criminal investigations by the Financial Conduct Authority (FCA). Having had the benefit of a 12-month secondment at the criminal prosecutions team at the FCA, she has particular insight into the organisation's approach to the investigation and prosecution of serious financial offences.

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Jonny Frank, a partner at StoneTurn, helps organisations and counsel remediate misconduct and address regulatory findings. He joined StoneTurn from PwC, where he was a partner, and globally led the fraud risk & controls practice. He also served as the executive assistant United States attorney, Eastern District of New York, a senior faculty fellow at the Yale School of Management and an adjunct associate professor at Fordham University Law School and Brooklyn Law School.

CD: Could you provide an overview of recent regulatory investigations in the financial services (FS) sector? What key trends would you highlight?

Lorimer: In recent months, we have seen the first signs of new investigations being opened in the UK. Most striking is arguably the crackdown on so-called ‘finfluencers’ – social media influencers who are alleged to use their platforms to promote financial products and services in breach of Financial Conduct Authority (FCA) rules. The FCA has opened criminal investigations into at least 20 of these individuals, as well as issuing a series of alerts. This follows the FCA’s decision to bring charges against a number of former ‘Love Island’ contestants in May 2024 for promoting an unauthorised foreign exchange scheme on social media.

Frank: Recently, regulatory activity in the financial services (FS) sector has looked to areas like financial crime and anti-money laundering (AML), as well as technology-centric issues such as cyber security and digital assets. Regulators are applying increasing scrutiny on AML compliance, imposing substantial penalties for failures in identifying and reporting suspicious transactions. Financial institutions (FIs) are being held to higher standards, requiring robust risk assessment and monitoring systems to prevent financial crime. Additionally, FS organisations face

increasing pressure to protect sensitive customer data, with data breaches leading to significant regulatory action and reputational risks, as well as costly data loss. Emerging areas such as digital assets and cryptocurrencies have seen a renewed focus, with regulators seeking to balance both clear guidelines and healthy innovation.

Webber: FS investigations continue to centre around the FCA’s identified priority areas. The prevention of financial crime, and financial crime systems and controls – including sanctions controls – remain key priorities and account for the highest number of FCA enforcement cases. Consumer protection remains another major focus. Activity includes targeting misleading financial promotions to consumers by ‘finfluencers’ – 20 have been interviewed under caution and nine criminal cases are pending. Elsewhere, two recent substantial enforcement fines have been meted out to lenders for failing to treat customers in financial distress fairly. The FCA is also heavily involved in the emerging motor finance mis-selling controversy, where a major skilled person review is ongoing involving multiple major lenders. The FCA also continues to act to ensure firms only have the regulatory permissions they need and that consumers are not misled as to the scope of their regulated activities under the ‘use it or lose it’ initiative.

CD: How would you describe recent monitoring and enforcement activities by the authorities? To what extent are financial institutions (FIs) being subjected to more rigorous investigations that may lead to disputes?

Frank: Authorities are increasing audits and demanding comprehensive reporting to ensure FIs uphold regulatory standards, with a focus on areas vulnerable to financial crime or consumer harm. Non-compliance is met with swift penalties, and violations that may have previously been seen as minimal are leading to substantial fines and remediation requirements. This refreshed oversight often involves detailed inspections of internal policies, risk management and data protection practices. FIs facing these rigorous investigations are more likely to encounter disputes, especially when regulations evolve at a faster pace than compliance policy. Overall, these enforcement trends signal a push toward greater accountability and transparency in FS.

Webber: The FCA's most recent enforcement data shows a trend away from FCA-led enforcement investigations. Other forms of regulatory intervention continue to increase, including an uptick in both the

use of skilled person reviews and the 'agreement' of voluntary requirements as mechanisms to monitor and control firms' behaviour. The FCA is not afraid to act assertively though, as recent criminal convictions for insider dealing and a number of significant fines against large FIs show – including £29m levied

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against Starling Bank. It has also used some less commonly used powers and acted in some novel contexts, such as the criminal and enforcement activity in relation to cryptoasset automated teller machines and crypto trading and a first FCA fine for an audit firm. Overall, we may be witnessing a move toward fewer, more impactful enforcement investigations, with echoes of its former 'credible deterrence' approach.

Lorimer: The FCA has intensified its monitoring of primary and secondary markets with a view to detecting irregular trading activities which may be indicative of market abuse. In primary markets, the regulator has opened numerous enquiries into potential leaks relating to issuers' fundraising activities. In secondary markets, it has invested very significantly in its data capabilities to allow it to review vast quantities of data every day, providing it with unprecedented visibility into patterns of trading. For example, earlier this year, the FCA reported on the case of Bytes Media. By analysing market data, the FCA was able to detect missing notifications and uncovered undisclosed trades in the shares of the company by the chief executive. This has led to a request for information from the FCA to the firm about the share trading of the chief executive, and subsequently resulted in the chief executive's resignation. There was no formal investigation but those enquiries brought about a swift outcome.

CD: Are you seeing any common themes or recurring issues in recent regulatory investigations involving the FS sector?

Webber: A recurring issue in FCA investigations in recent years has been the length of time

investigations take to complete. This can hang over firms and affected individuals and impact on smaller firms' financial viability while investigations

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are ongoing. Efforts are being made to pick up the pace and bring longer running investigations to a conclusion, but there is clearly more work to be done. We are seeing a significant increase in criminal prosecutions by the FCA, particularly around breaches of the regulatory perimeter and fraud. The FCA is also increasing its use of pre-enforcement interventions to seek to achieve prevention rather than cure where threats to consumers are identified, in response to criticism in recent years of failure to act earlier and more decisively to prevent major mis-selling scandals like London Capital & Finance plc.

Frank: There has been a trend toward providing regulatory clarity through enforcement actions, such as those from the US Department of Justice (DOJ). Over the last two to three years, the DOJ has outlined what it expects from organisations to maintain a culture of compliance through a number of speeches, updates to policy and increased transparency. Maintaining that compliance posture includes tone at the top, and we have seen pressure on individuals and institutions as a result. In emerging FS organisations, such as cryptocurrencies, the call for greater transparency continues. This is not just around transparency within those institutions, but from governments and regulatory bodies on what the regulatory expectation is.

CD: If an FI finds itself subject to a regulatory investigation, how should it respond? What general steps should be taken at the outset and throughout the process?

Webber: Responding quickly and appropriately to a regulatory investigation is crucial. A firm must demonstrate to the regulator that it has appreciated the seriousness of the issue and will engage constructively. If it does, the prospects of a supervisory, rather than an enforcement response, improve. Denial or defensiveness have the

opposite effect. Firms should identify and empower appropriately senior individuals to investigate and coordinate the firm's response and show that the firm has a grip on the issue. They should engage investigations experts early to avoid missteps in planning the firm's response. Consistent messaging internally, and where appropriate, externally, are important. If fraud or a risk to customers' assets is suspected, or critical customer services are disrupted, firms will be expected to have and rapidly implement plans to limit any harm, as well as establish what has happened and lessons to learn. We often see firms sanctioned not only for the underlying issue but for their response to regulatory intervention.

Frank: Each investigation has its own nuances and differences, so first and foremost organisations should work closely with their counsel and advisers to get a fulsome picture of the landscape and their exposure. But, in an ideal world, organisations would have prepared for such a scenario. FIs should foster a 'what could go wrong?' mindset organisation-wide, encouraging proactive thinking around events and scenarios rather than traditional risk labels. Incorporate 'what could go wrong' into formal risk assessments and everyday operations, using red team exercises and other games to sharpen predicting the unpredictable. Set a regulatory risk appetite. Assess likelihood in the absence of

controls. Consider the regulatory, financial, market and reputational impacts of each potential scenario, if the scenario were to materialise. Link potential events and scenarios out of risk appetite to the mitigating suite of preventive and detective policies, processes and controls. Beware of relying on them without independently testing design and operating effectiveness. Develop a risk response plan to bring out-of-appetite risks within appetite.

Lorimer: An FI's first priority should be to engage with the FCA and demonstrate that it is taking the issue seriously. To the extent that the investigation raises present-day risk issues, it should liaise closely with FCA supervision to take steps to mitigate these, regardless of whether the allegations under investigation are disputed or not. Instructing specialist lawyers and compliance consultants can assist.

CD: How can technology assist with large-scale document collection and review, which typically forms part of a financial regulatory dispute?

Frank: In cases involving large volumes of documents and disparate data in different formats, leveraging artificial intelligence (AI) can help get reviews started. For example, AI can be used to identify critical themes from interview transcripts,

which informs survey topics and questions, and help analyse employee survey results and follow-up focus groups. AI can also help organisations analyse large datasets more efficiently, saving time and mitigating human error or bias. While AI is highly effective in analysing data, human expertise remains crucial in fine-tuning AI models and interpreting nuanced insights. Collaboration between compliance professionals and data analysts ensures that AI tools are aligned with organisational needs and produce reliable results.

Lorimer: AI is likely to play an increasing role in the conduct of document collection and review. The firm itself may be conducting a review using these tools, or a law enforcement authority may be. Either way, new technology offers significant cost and time benefits, as well as providing what may be a more reliable and less partisan approach to review which can cut down areas of dispute between parties.

Webber: Technology assisted review tools are well established and are invaluable for assisting with document-heavy investigation exercises, enabling the intelligent sifting of very large volumes of data much more quickly and accurately than human review. They can be used by skilled investigations experts to prioritise where to target investigative efforts and identify themes. The FCA is itself using technology in its own work, even at the initial stage



of investigations, as part of its push to become a 'data-led regulator'. For example, Therese Chambers, joint executive director for enforcement and market oversight, noted in a recent speech that the FCA's tools were allowing around 1 billion records of trading data to be interrogated per day, together with the use of analytics to spot complex patterns to root out market abuse and other financial crime.

CD: What essential advice would you offer to FIs on identifying, managing and mitigating potential risks that could lead to a regulatory investigation or dispute?

Webber: Although the regulatory landscape is constantly shifting, paying attention to the FCA and Prudential Regulation Authority's thinking and moves is important to understand their concerns and priorities and develop a compliance framework accordingly. The FCA's 'Dear CEO' letters are particularly useful for highlighting focus areas in FS sectors relevant to a firm's business. Retaining a good compliance consultancy to provide regular horizon-scanning for relevant developments is often a sound investment. One trend we have seen recently is regulatory intervention arising as a consequence of firms responding to new business

opportunities or experiencing swift growth without ensuring that regulatory systems and controls have kept pace. We would counsel firms to be proactive and forward-looking in ensuring that their

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Kingsley Napley LLP*

compliance framework remains fit for purpose as their businesses develop. This is particularly true for smaller firms, which are less able to bear the costs and disruption of regulatory intervention.

Lorimer: FIs must stay on top of changes in rules and regulatory expectations. This minimises the risk of them being caught up in any thematic enquiries which can be disruptive. Where FIs identify particular areas of risk, it is important to seek specialist assistance, from external providers if appropriate, to address these as a matter of urgency. Regulators expect firms to get on the front foot when issues

come to light. Rather than firefight issues as and when they arise, firms need to take a proactive approach to ensuring that there are no wider problems. It may be worth instructing an external compliance consultancy – with a demonstrable record of credibility with the regulator – to conduct a ‘root and branch’ review of the business to ensure that any other areas of weakness are identified and remedied before the risk crystallises.

Frank: For FIs aiming to manage and mitigate risks that could lead to regulatory investigations or disputes, a critical action is to implement thorough documentation of compliance activities and proactive policies. Documenting each step taken to address potential issues – such as enhanced due diligence on high-risk clients or improved cyber security protocols – not only demonstrates commitment to regulatory standards but also serves as valuable evidence in case of future audits or investigations. Institutions should proactively adopt policies that address areas frequently flagged by regulators. This involves regular risk assessments, updating policies to reflect the latest regulatory changes, and training employees on compliance best practices. Consistent monitoring and documentation are key: by recording risk management actions and control measures, FIs can better manage risks while providing a clear, defensible record of compliance efforts that may be crucial in any regulatory

review or dispute. We often call this a ‘good deeds scrapbook’.

CD: What is the outlook for regulatory investigations and disputes in the FS sector? What developments do you expect to unfold over the months ahead?

Lorimer: A big area of focus is non-financial misconduct. The FCA has recently published the results of a survey it carried out of 1000 investment banks, brokers and insurance firms focusing on allegations of bullying, harassment and discrimination logged between 2021 and 2023. In tandem with new rules on non-financial misconduct, we can expect an uptick in investigations – of firms and individuals – in this area. The FCA is also battling to defend its proposal to ‘name and shame’ firms under investigation despite huge backlash from industry and government. If its proposals are implemented, it will represent a real risk for firms that find themselves caught up in investigations, as for many, the reputational damage at the point of publication – whatever the ultimate outcome of the investigation – will be irreparable.

Frank: Over the coming months, we can expect enhanced regulatory focus on transparency and accountability, with stricter penalties for non-compliance and greater emphasis on proactive risk

management. Cross-border regulatory cooperation may also increase, particularly in combatting global financial crime. FIs will need to stay agile, adjusting policies and technologies to meet evolving regulatory expectations, as failure to do so could lead to disputes, fines and long term reputational damage.

Webber: We expect to see an evolution of the regulatory approach toward more data-led early intervention as well as creative use of supervisory powers and tools like skilled person reviews, to enable the FCA to do more with less. We predict a corresponding continuation of the trend toward fewer and hopefully quicker enforcement investigations, with a renewed focus on cases that will be impactful in terms of sending strong messages to relevant audiences. In retail FS we expect that the Consumer Duty will increasingly be invoked in both supervisory and enforcement interventions, following a post-implementation honeymoon period. We are also expecting that the FCA's work on motor finance mis-selling will culminate in a substantial consumer redress scheme under section 404 of the Financial Services and Markets Act. Lastly, we expect the FCA to row back on its proposals to 'name and shame' firms under investigation, in recognition of the widespread and well-made criticisms those proposals have attracted.

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