Why Nonfinancial Misconduct Should Be On Firms' Radar

By **Charlotte Pope-Williams** (January 22, 2025)

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The Financial Conduct Authority has made abundantly clear that nonfinancial misconduct, or NFM, comes within its regulatory remit.

Rules, policy or guidance about NFM are likely to come out at some point this year following the report from the last quarter of 2024 on the FCA's NFM survey. This showed substantial increases in NFM from 2021 to 2023 in bullying and harassment.[1]

The regulation of NFM by bodies such as the FCA, the Prudential Regulation Authority, the Bank of England and other financial services regulators gives rise to philosophical and jurisprudential questions about the extent to which the government can and should, as principal, be outsourcing the governance and policing of broad societal ethical issues, for example, the treatment of women in the workplace.

Questions include:

- Is it properly a financial services regulator's place to police general conduct, e.g., how one behaves at a work party, which is not strictly within the ambit of the provision of financial services? On the other hand, where NFM occurs in regulated financial services environments, if not the FCA in particular, then who? The FCA is the regulator of financial services conduct, after all.

- Do the FCA, the PRA and other financial services regulators have the capability and capacity to police in NFM, not least given recent criticisms of the FCA's own internal culture.

The FCA has said that NFM is "misconduct and not an additional principle." It goes on to characterize NFM as including "individuals' conduct for issues such as (but not limited to) bullying, sexual harassment, and discrimination whether in or outside the workplace."[2]

While there have been various statements about what NFM includes, what is strikingly absent is a single, clear and definitive definition of precisely what the U.K.'s financial regulators mean by NFM. Effectively, NFM relates to a culture of a firm, and the U.K.'s financial services regulators are seeking to regulate to ensure that so-called good cultures exist. However, what constitutes good culture is relative and highly subjective. This is particularly the case where firms and individuals operate on a multinational or global basis and are thereby subject to variable cultural norms.

Further, the U.K. and global economy finds itself facing geopolitical headwinds, e.g., changing views about what constitutes free speech in the 21st century, which directly affect what constitutes good culture, a concept that is subject to constant change.

One should not forget that the statutory instruments with which the FCA, PRA and others regulate have the force of law. It is an unenviable task, particularly for large international regulated firms, to pin down what lawful conduct should look like in respect of NFM across possibly thousands of employees and innumerable different scenarios, some of which may be only tangentially connected to the provision of financial services.

While the phraseology of NFM might be new to some, the concepts underlying it are not. The central notion being that bad or poor culture within firms and regulators can lead to the crystallization of financial risks, which can harm consumers and financial stability.

Issues with definitions aside, the FCA's latest survey results highlight that over the three-year survey period from 2021-2023, NFM increased, with bullying and harassment (26%) and discrimination (23%) being the most reported forms of NFM on a cross-sector basis; albeit that 41% of NFM was reported as "other."

Arguably, something needs to be done, but it is not clear whether the financial services regulators are best placed to take action in circumstances where they have been aware of the issues underlying NFM for some time, limited progress appears to have been made, and the internal culture of the regulators themselves has been met with some criticism and scrutiny.[3]

In the last quarter of 2024, the FCA's culture recently came under scrutiny in the all-party parliamentary group report on investment fraud and fairer financial services. Published in November, the report stated: "The picture painted is not pretty. The FCA is seen as incompetent at best, dishonest at worst. Its actions are slow and inadequate, its leaders opaque and unaccountable."[4]

According to the FCA's 2024 enforcement data,[5] the FCA opened fewer enforcement investigations compared to 2023, and it strengthened its supervisory teams.

This could indicate more supervisory regulatory action in the form of commissioning skilled persons and Section 166 reports, i.e., reports by independent experts about a regulated financial services firm undertaken pursuant to Section 166 of the Financial Services and Markets Act 2000, and the imposition of requirements as opposed to penalties.

There is a good argument that strong enforcement action is required to tackle NFM, and that heavy reliance on supervisory actions will not suffice and has not worked thus far.

Practical Issues

There remains the practical and perennial issue of what firms should practically be doing now in respect of NFM. The FCA has said that it expects firms to have systems and controls in place to identify and mitigate NFM risk. It also expects prompt investigation and remedial action where any NFM risk crystallizes.[6]

One way to interpret this type of statement from the FCA is that it is sending a clear message that extant rules in the FCA handbook, and the general common law, prohibit NFM. It is therefore a matter of viewing the FCA and PRA rules through the lens of NFM and also noting that firms are expected to self-regulate to a degree by having adequate policies and procedures in place.

Firms would therefore be well advised to focus on the following key regulatory requirements contained in the FCA handbook and PRA rule book when seeking to minimize the risk that NFM could occur, namely: the senior management arrangements, systems and controls, the fit and proper test for employees and senior personnel, the code of conduct, as well as Principle 1 in the FCA's Principles for Business and PRA Fundamental Rule 1, which both provide that "A firm must conduct its business with integrity."[7]

So, what is next in respect of the FCA and NFM? According to the FCA, nothing immediate. The FCA appears to be in a hiatus as regards NFM. In its latest statement on the matter it said that it would not be publishing best practice or guidance at present, but that it would be finalizing its policy in due course, including how NFM should feature in the FCA handbook.[8] In consultation paper 23/40, published in June 2023, the FCA, PRA and Bank of England included relatively detailed proposals about including NFM in:

- Conduct rules;
- Fit and proper assessments; and
- Suitability guidance on threshold conditions. These proposals will arguably be a starting point for any NFM-related rules or guidance.

Practical Steps for Firms

While the FCA is not hurriedly implementing NFM rules, rules or further guidance about NFM are coming and therefore firms and individuals should not rest on their laurels in respect of NFM. There are some practical steps that firms could take now to better ensure regulatory compliance in respect of NFM in the future, including but not limited to:

- Ensure that all relevant policies are up to date and specifically tailored to the individual business, such as whistleblowing policies, remuneration policies, diversity, equity and inclusion policies, and disciplinary policies. The FCA's NFM survey findings highlighted that "some relevant policies, like whistleblowing and disciplinary policies, were not in place at all firms surveyed."
- Monitor and collect data about what is happening in a particular organization in the context of NFM, and ensure that the board or the relevant subcommittee have clear oversight of firm culture.
- Ensure a clear understanding of existing standards that are relevant to NFM in the relevant sections of the FCA handbook, including the Fit and Proper test for Employees and Senior Personnel, the Code of Conduct, the Senior Management Arrangements, Systems and Controls and Principles 1, etc., as well as other relevant legislation such as the Equality Act 2010. Moreover, it is often the case that firms and individuals see NFM as an employment law or staff relations issue without focusing sufficiently on NFM's impact on the financial services regulators' statutory aims, e.g., a firm's safety and soundness and protecting consumers from harm caused by poor conduct.

The underlying conduct that results in NFM is neither new nor unfamiliar to the regulators or to society at large. It can only be hoped that the next set of measures from the U.K. financial services regulators relating to NFM can help to move the dial.

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[1] https://www.fca.org.uk/data/culture-non-financial-misconduct-survey-findings#lf-chapter-id-our-survey-the-survey-data.

[2] https://www.fca.org.uk/publication/correspondence/culture-nfm-survey-letter-insurers-insurance-intermediaries.pdf.

[3] The Bank of England has been criticised about the alleged increase in bullying during the tenure of Mark Carney https://jerseyeveningpost.com/morenews/uknews/2018/10/10/bank-of-england-faces-probe-after-bullying-and-harassment-rise-under-mark-carney.

[4] https://www.theguardian.com/business/2024/nov/26/fca-mps-peers-financial-conduct-authority-appg-report and https://www.appgifffs.org/wp-content/uploads/2024/11/FINAL-Call-for-Evidence-Report-PUBLIC-1.pdf.

[5] https://www.fca.org.uk/data/fca-enforcement-data-2023-24.

[6] Ibid FN1.

[7] https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html and https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/new-bank/fundamentalruleprinciples.

[8] https://www.fca.org.uk/data/culture-non-financial-misconduct-survey-findings#lf-chapter-id-next-steps.