

17 February 2025

Via: Online Submission Form

Enforcement Law and Policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Re: CP24/2, Part 2: Greater transparency of our enforcement investigations

Dear Sir/Madam,

MFA¹ appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the Financial Conduct Authority's ("FCA's") Consultation Paper 24/2, Part 2: "Greater transparency of our enforcement investigations" ("**Supplemental Consultation**"),² a supplement to the FCA's initial Consultation Paper 24/2 ("Enforcement Guide and Publicising Enforcement Investigations") (the "**Original Consultation**" and, together with the Supplemental Consultation, the "**Consultations**").³ MFA's comments today build upon our previous comment letter responding to the Original Consultation ("**Original MFA Comment Letter**") and the two should be considered in tandem.⁴

While MFA appreciates the FCA's efforts in attempt of improving the Original Consultation, the Supplemental Consultation retains precisely the same set of substantial flaws as the Original Consultation and actually introduces new ones. The Supplemental Consultation makes *de minimis* changes in approach, therefore remaining fundamentally flawed and should not move forward. Despite the additional considerations and longer notice periods referenced in the Supplemental Consultation, the revisions the Original Consultation proposed to the Enforcement Guide remain unchanged. MFA's deep concern with the Original Consultation is unchanged with the marginal revisions reflected in the Supplemental Consultation and MFA again urges the FCA to withdraw the Consultations, which would be compatible

¹ Managed Funds Association ("**MFA**"), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

² Financial Conduct Authority, Greater transparency of our enforcement investigations, Consultation Paper 24/2, Part 2 (28 Nov. 2024) (avail. at <https://www.fca.org.uk/publication/consultation/cp24-2-part-2.pdf>).

³ Financial Conduct Authority, Our Enforcement Guide and publicising enforcement investigations - a new approach, Consultation Paper 24/2 (27 Feb. 2024) (avail. at <https://www.fca.org.uk/publication/consultation/cp24-2.pdf>).

⁴ See Letter from MFA to FCA on Consultation Paper 24/2 (30 Apr. 2024) (avail. at <https://www.mfaalts.org/wp-content/uploads/2024/04/MFA-Response-to-CP24-2-FCA-Public-Announcement-of-Investigations-043024-FINAL.pdf>).

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with the FCA's growth and competitiveness objective.

MFA remains firmly of the view that the enhanced transparency and investor protection measures sought through the Consultations can be achieved under the FCA's existing authority without adding new, redundant authority to name publicly a firm or an individual under investigation where the FCA has not drawn any conclusions regarding any breach of rules of regulatory standards. The FCA currently has authority to make investigations public if it deems "extraordinary circumstances" are present. MFA urges the FCA to use this existing authority rather than introduce the subjective, and shifting criteria outlined in the Consultations.

Executive Summary

We summarise our response, including addressing the four principal revisions to the Original Consultation reflected in the Supplemental Consultation below, with additional detail to follow:

- The additional considerations listed in the Supplemental Consultation leave unchanged the fact that the criteria are subjective, undefined, and left solely to the FCA Staff to define, implement, and interpret.
- The additional criteria listed in the Supplemental Consultation do not amend or limit the proposed amendments to the Enforcement Guide in the Original Consultation and therefore the Supplemental Consultation retains the flaws of the Original Consultation:
 - Consideration of impact of an announcement on the relevant firm does not address the shortcomings of the Original Consultation and would require considerable speculation on the FCA Staff's part;
 - Providing firms a copy of the draft announcement, and then ten business days for the target firm to respond to the FCA, similarly does not remedy the negative (and potentially fatal) impact of the naming of an investigation and is likely to create a cascade of redemptions as first movers seek an exit before publication;
 - Similar to the above new consideration of potential impact on the firm, including as a consideration the potential of an announcement to "seriously disrupt" public confidence as a new factor is equally subjective and exceedingly difficult for the FCA or anyone else to quantify before an investigation announcement is made; and
 - In what should be a moot point if the FCA withdraws the Consultations, MFA supports not applying any new investigation publication criteria to investigations that are pending should the Original Consultation's revisions to the Enforcement Guide become effective.
- In addition to the persisting, fundamental, and irrecoverable flaws of the Supplemental Consultation, MFA continues to disagree strongly with the FCA's apparent view that no cost-benefit analysis is required.

A. The additional considerations listed in the Supplemental Consultation leave unchanged the fact that the criteria are subjective, undefined, and left solely to the FCA Staff to define, implement, and interpret

The Supplemental Consultation, despite the FCA’s efforts to recast it as something benign and used sparingly in extraordinary circumstances, remains flawed and should be withdrawn.⁵ The additional considerations listed in the Supplemental Consultation leave unchanged the fact that the determination of whether to publish investigation information is subjective, undefined, and left solely to the FCA Staff to define, implement, and interpret. These subjective criteria, interpreted and implemented by the relevant FCA Staff at the time, undoubtedly will shift over time and what may be a “focused number of cases” today could balloon to something vastly different in the future.⁶

The effect is that the interpretations and ultimate decision of whether to name a market participant ultimately is left to the FCA Staff in place at that time, resulting in inconsistent and potentially unfair application of the standards to the detriment of UK market participants over time. As we noted in the Original MFA Comment Letter, the FCA’s proposals represent a material shift in approach that is inconsistent with that of a financial regulator in a major global financial centre. Apart from the Monetary Authority of Singapore, the FCA has not identified any other financial regulator that publicly identifies subjects of ongoing investigations. MFA considers that the Consultations are likely to affect adversely the competitiveness of the UK as a jurisdiction of choice for investment firms.

The very real and consequential harm of the publication of an unresolved *investigation* is left wholly unaided by the changes introduced in the Supplemental Consultation. The additional factors the FCA considers, which we discuss below, themselves are wholly subjective and can be interpreted by the FCA Staff to either support publicising an investigation but against whom charges have not been brought, or precisely the opposite. While the FCA Staff is free to weigh the various considerations solely as it deems appropriate, emphasising and deemphasising risks and potential harms to suit the conclusion sought, the damages to market participants, investors and clients, and the UK financial system as a whole, are very real and the effects on the firm and its individuals are harmful and long-lasting.

MFA members are predominately alternative investment fund managers (“AIFMs”) that manage private funds such as alternative investment funds (“AIFs”) in the UK, EU, US, and elsewhere. AIF investors are sophisticated, often institutional investors such as pensions, foundations, and endowments. These institutional investors are often advised by consultants and other investment professionals and often maintain a professional staff of investment professionals.

⁵ Whilst the FCA’s proposals are clearly most concerning in relation to firms, and the FCA states that its proposal is “*usually not to announce that [it is] investigating a named individual*” (see note 3, *supra*), the FCA also states that “*there will be circumstances when [it] can lawfully make such an announcement in the public interest*” (*id.*, at p. 15, §3.18 (emphasis added)). MFA does not support any proposals to change the FCA’s approach to naming firms and individuals under investigation without significant safeguards. For the purposes of this response, MFA’s objections are to any changes in relation to firms or individuals, though with a focus on firms since this is the most drastic change proposed.

⁶ Speech by Therese Chambers, joint executive director of enforcement and market oversight, delivered at AFME Annual European Compliance and Legal Conference, “Change for the better: the FCA’s evolving approach to enforcement” (24 Sept. 2024) (avail. at <https://www.fca.org.uk/news/speeches/change-better-evolving-approach-enforcement>).

Investors seek exposure to AIFs of various strategies through a request for proposal process where they conduct extensive initial due diligence on an AIF and its manager, including investment strategies, performance, personnel, and various regulatory matters.

The effects of the FCA's Consultations, if adopted, would have serious, damaging, and permanent consequences on a named firm that is an AIFM/AIF, even if the investigation results in no ultimate finding of wrongdoing. The investigation conclusion is irrelevant by that point, as the damage to the fund, and relations with its investors, regulators, counterparties, lenders, and employees has already been done. These real-world consequences that would be visited upon AIFs and AIFMs, solely through a decision by the FCA Staff to publicise the mere existence of an investigation touch upon all aspects of the manager's and fund's business activities and relationships:

- ***The fund*** -- A significant, sudden increase in redemption requests from existing investors or termination notices from existing clients and investors:
 - This wave of redemptions is likely to contribute to market depreciation and dilute the value of remaining investors' holdings; and
 - Create "fire sale" risk as managers are forced to prematurely dispose of assets to meet redemptions.
- ***Investors*** -- Material obstacles in attracting new investors or new clients:
 - A public investigation announcement by the FCA would constitute a "red flag" on any investor due diligence process, meaning that a significant number of investors will decline or block a new investment or increasing an existing investment with a firm under investigation;
 - Investors are likely to be alarmed by an announcement of an investigation and be unable to commit to invest with a firm under investigation, even though at the time the disclosure was made, the firm would not have been found to have engaged in any misconduct; and
 - The announcement identifying a firm may in some cases be taken by investors to indicate that there is a real prospect that a breach or other misconduct or failing has in fact taken place, despite the fact that it may be years before a firm is able to reassure its investors that, in fact, no misconduct ever resulted from the FCA's investigation publication.
- ***Counterparties*** -- Material obstacles in establishing new counterparty or trading relationships:
 - A public announcement by the FCA regarding an investigation concerning a firm will be alarming to market counterparties and constitute a "red flag" during counterparty due diligence, particularly non-UK counterparties that may be less familiar with the FCA's unique approach to enforcement investigations;
 - Those dealers that move forward with the counterparty are likely to require more onerous contractual terms, higher margin rates, and less-forgiving margin deadlines;
 - Even if the FCA investigation results in no finding, as many do, the damage to counterparty relationships – and by extension – business prospects, will already have been done; and

- Time to establish new counterparty relationships may be significantly lengthened, and in some cases, counterparties will not approve a firm that they know is under investigation (and, if the firm is later found not to have engaged in any misconduct, then it would be necessary to amend their trading documentation, which itself can take months).
- **Lenders** -- An adverse impact on borrowing or other lending arrangements:
 - Lenders are likely to raise rates and the cost of financing due to a perceived increased credit risk *solely* because of the publication of the investigation):
 - An investigation announcement by the FCA would likely result in the firm's risk profile being adjusted higher by its lenders, resulting in higher borrowing costs and less advantageous terms, all of which will be compounded over time and difficult to undo if the firm is found to have engaged in no wrongdoing.
- **Share price** -- Likely depreciation of the market price of publicly traded firms (or firms with publicly traded parent companies):
 - An early investigation announcement, for an investigation that may continue over a number of years, will likely create a long-term drag on the share price of a publicly traded company, unfairly and unnecessarily depleting shareholder value over a prolonged period;
 - Market participants also may take short positions against issuers identified in any FCA publication, even though there has been no change to the firm's profitability or business; and
 - In such cases, increased short interest rightly would be attributed solely to the FCA's public investigation announcement.
- **Employee retention and recruitment** -- Difficulties in staff recruitment and retention:
 - Solely because of a public announcement of an investigation, the target firm would likely experience material challenges in seeking to retain and to recruit staff, particularly senior professionals and legal and compliance staff; and
 - Firms may be required to pay a higher "risk premium" in recruitment and retention costs for qualified staff;
 - This risk premium would apply most pointedly to compliance, risk management, and legal staff, with the increased cost burden would operating as an *de facto* penalty on a firm before the FCA has reached even any *preliminary* findings of wrongdoing.

It bears repeating that each of these consequences is very real, based on the experience of MFA members in working with fund investors, counterparties, lenders, and employees during times of stress or regulatory inquiry. Under the Consultations, these real-world impacts, which negatively affect shareholders and employees far removed from any investigation the FCA is conducting, are brought to bear solely because the FCA Staff's unilateral decision to publicise an ongoing, unresolved investigation. There moreover does not appear to be any considerable increase in pervasive misconduct or fraudulent behaviour that would warrant this unprecedented and unparalleled regulatory overreach by proposed by the FCA. The peripheral changes brought about by the Supplemental Consultation do not change the

fundamental unfairness and seriously flawed nature of the Original Consultation.

B. The additional criteria listed in the Supplemental Consultation do not amend or limit the proposed amendments the Enforcement Guide in the Original Consultation and therefore the Supplemental Consultation retains the flaws and unworkability of the Original Consultation

MFA recognises the additional notice period to investigative targets under consideration for public naming, combined with the additional considerations of impact to the firm, the markets, and the broader financial services ecosystem in the UK and beyond. These additional considerations in practice would do nothing to change the flaws of the Original Consultation that the FCA seeks to rehabilitate through the Supplemental Consultation. The Consultations therefore should be withdrawn.

The Consultations retain the fact that naming a firm under investigation, before resolution or even any finding of wrongdoing, threatens the firm and the industry itself with very real and lasting, substantial, and potentially fatal consequences to the life of the firm. The Supplemental Consultation, again, leaves wholly unamended the changes to the Enforcement Guide proposed in the Original Consultation.

This all-encompassing authority would rest solely in the hands of the FCA Staff, whoever it may be at any time during the lifespan of this policy (if adopted) for it to use as it sees fit against whichever investigative targets it deems deserving of the publication of an ongoing investigation. For these reasons, and as discussed in greater detail below, MFA continues to urge that the FCA withdraw the Consultations and continue to rely on its ample, existing authority to publish investigative information under extraordinary circumstances, which has served the markets well by informing the public where circumstances truly warrant.

1. Consideration of impact of an announcement on the relevant firm does not address the shortcomings of the Original Consultation and would require considerable speculation on the FCA Staff's part

The fact that the FCA Staff is required to consider the potential impact to the firm and to the broader markets is subjective and arguably hollow: it takes a limited imagination to surmise that, when considering whether to publish information about an enforcement investigation, the FCA Staff could find ample support that publication would not materially impact the firm or the broader markets. It would require perhaps slightly more imagination to reach the opposite conclusion – that naming an enforcement investigation target would affect the firm and/or the markets and elect not to name the individual and/or firm under investigation.

It is difficult if not impossible, even with perfect information and extensive forecasting, analyses, and modelling, for the FCA to assess accurately the impact on the firm of a potential investigation announcement. The firm can provide its own best estimates of impact, but there is no requirement for the FCA to consider fully the representations made by the firm. While the high likelihood of significant investor redemptions after the FCA's publication of an ongoing, unresolved investigation is readily foreseeable, the degree of investor redemptions is nearly impossible to estimate – would it be 10%? 30%? More? What would that withdrawal represent in terms of departing assets – a handful of large investors acting on the recommendations of their investment professionals (both in-house and externally) and/or

investment consultants? Would the FCA's investigation publication encourage other regulators to commence their own piggyback investigations into the target and its personnel?

Moreover, would this investor exodus be permanent or could the AIF expect some number of investors to return, particularly if the FCA concludes the investigation with no findings? The investors that redeemed out of the AIF upon publication of the investigation or earlier are likely to have redeployed that capital elsewhere during the pendency of the FCA investigation, so the departed capital is unlikely to return to the AIF at least for the foreseeable future.

The analysis conducted by the FCA Staff could politely be described as speculative, resting on a wide range of assumptions and forecasting that may or may not prove accurate. But, by the time history proves the level of accuracy in FCA Staff's assessment of the risk of harm to the firm or individual under consideration for publication, the damage to both has been done. In addition, there is nothing that would prevent the Staff, upon reaching a conclusion that publication *would* harm the firm but electing to publicise the investigation anyway, presumably because the FCA Staff in its reasoned judgment concluded that other factors *outweighed* the harm to the firm in favour of publication.

This "consideration" therefore does nothing to remedy the fatal shortcomings of the Original Consultation.

2. Providing firms a copy of draft announcement, and then ten business days for the target firm to respond to the FCA, similarly does not remedy the negative (and potentially fatal) impact of the naming of an investigation and is likely to create a cascade of redemptions as first movers seek an exit before publication

MFA appreciates the additional notice period to inform clients and investors but notes the additional time would only cause the inevitable investor departures to begin at an earlier date. AIFMs likely would use the additional time to meet contractual notice requirements to AIF investors. The effect inevitably would be that some (or many) investors would use this pre-publication period to redeem their investments before publication, creating a "run" on the fund and exacerbating client departure in anticipation of a broader wave of redemptions upon publication of the pending investigation.

The Supplemental Consultation also gives firms a Hobson's Choice of determining the sequencing of investor notifications. Information about an unresolved investigation by its nature is a sensitive subject that does not lend itself to a mass email communication or website posting, and as such the manager's investor relations team would be contacting investors by phone to have these sensitive conversations. In what order should the manager notify its investors? Each option carries with it regulatory and litigation risk of complaint from the investors that were not contacted in the early tranches.

The FCA should not be in the business of sanctioning a first mover advantage and placing AIFMs in a situation where they have to prioritise some investors clients over others because it simply is not possible to communicate effectively with all investors the looming FCA publication of an ongoing, unresolved investigation and afford clients and investors the opportunity to ask questions or seek additional information. The Consultations must be withdrawn.

3. **Similar to the above new consideration of potential impact on the firm, including as a consideration the potential of an announcement to “seriously disrupt” public confidence as a new factor is equally subjective and exceedingly difficult for the FCA (or anyone else) to quantify before an investigation announcement is made**

If it is unlikely that the FCA can accurately assess the impact of an investigation announcement on an individual firm, as discussed above, it is even more unlikely that an assessment can be made of the impact of a potential announcement on the broader markets or the financial systems as a whole.⁷ As with the potential firm impact, an estimation made solely by the FCA Staff of an investigation announcement on the broader markets, or the financial system as a whole can be fashioned conveniently to fit whatever conclusion the FCA Staff seeks to support at that time.

If the FCA Staff is inclined to issue an investigation announcement, it can readily support a conclusion that the announcement would not have an impact on the markets or the financial system. If that conclusion turns out to be incorrect and the markets or the financial system in fact has been harmed, the FCA cannot undo the announcement or otherwise “take it back.” The damage caused by the FCA Staff’s flawed assessment of market harm has already been done.

4. **In what should be a moot point, MFA supports not applying any new investigation publication criteria to investigations that are pending should the Original Consultation’s revisions to the Enforcement Guide become effective**

MFA urges that these last criteria prove to be a moot point, as the FCA should not move forward with the Consultations. The legitimate concerns expressed here and in the Original MFA Comment Letter, in addition to those of the financial services industry more broadly, must be given due consideration and the FCA should withdraw the Consultations.

- C. **In addition to the persisting, fundamental flaws of the Consultations, MFA continues to disagree strongly with the FCA’s view that no cost benefit analysis is required**

As we noted in the Original MFA Comment Letter, the FCA has customarily provided a cost-benefit assessment where the new rules, policies or processes include novel or uncustomary elements. The Consultations are novel, as we note no other jurisdiction beyond Singapore that imposes such an approach to enforcement publication.

The Supplemental Consultation states that the FCA is declining to produce a cost-benefit analysis because it does not view the Consultations as either rules, for which a cost-benefit analysis is required, or guidance, for which the FCA’s practice is to produce a cost-benefit analysis.⁸ We note that there is no legal or regulatory reason that would *preclude* the FCA from providing a cost-benefit analysis to at least consider the potential costs on firms.

⁷ See *supra* note 2, at §4.10.

⁸ See note 2, *supra* at §2.8.

We disagree that the Consultations would require firms to take any particular steps. AIFMs are fiduciaries to the funds they manage and would have an obligation to inform their investors of an impending publication by the FCA. There will be some percentage of a fund's investors that redeem out of an AIF upon notification that the FCA Staff is inclined to publish information on a pending obligation and a second wave that will redeem upon publication. A firm that is the subject of an investigation publication would require significant contingency provisions to address potentially material increases in operational and business costs, to the detriment of investors as well as firms. The FCA has an obligation to the markets to at least attempt to determine what it believes that impact to be, publish it for comment, and consider feedback from the regulated industry as to its assessment of potential harm.

MFA considers the FCA's position in the Consultations that the effect of the announcements on the firms or individuals under investigation is effectively irrelevant to its assessment process to be unreasonable and inaccurate. If the FCA insists upon forging ahead despite the near-universal objection to the Original Consultation, it is imperative that the FCA conducts a thorough cost-benefit analysis to assess the costs to the firm that is the recipient of a pre-resolution investigation and to the broader markets and financial system in the UK.

D. Conclusion

The FCA's existing tools to publish current trends and topics of investigations and enforcement actions by regulatory authorities generally are well-received by MFA members and helpful to asset management firms by highlighting compliance topics and reminding firms of their regulatory obligations. The FCA's existing tools to notify the public under extraordinary circumstances of ongoing or considerable misbehaviour by firms or persons also has proven effective in informing the public of "bad actors" to avoid. MFA members find such proactive, educational efforts by the FCA helpful in firms' internal compliance and risk management processes and welcomes the opportunity to target their focus and resources on topics of concern to the FCA and its Staff.

These existing tools are more than sufficient to meet the FCA's transparency and investor protection goals, making the Consultations wholly unnecessary. MFA urges the FCA to withdraw the Consultations.

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We appreciate your consideration, and we would be pleased to meet with the FCA to discuss our comments. If you have any questions about these comments, please do not hesitate to contact Rob Hailey (rhailey@mfaalts.org), Jeff Himstreet (jhimstreet@mfaalts.org), or the undersigned (jhan@mfaalts.org).

Sincerely yours,

/s/ Jennifer W. Han

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