

# Regulatory exposures

By Mandip Sagoo, Partner Clyde & Co



Regulatory risk remains in fourth place on the list of top risks for D&Os this year but there was a range of difference across the regions. Whilst between 36% to 60% of responders from GB, US, Europe and Asia considered a regulatory breach as a very or extremely significant risk, that rose to 76% in Latin America and fell to just 8% in Australasia. As expected, larger companies and those operating in financial services placed the risk higher than companies operating in other sectors and with lower revenue.

## The FCA tackle unauthorized business to improve consumer protection

In GB, the Financial Conduct Authority (FCA) enforcement activity continues to be a substantial exposure for companies and D&Os. Specific target areas for the FCA are tackling unauthorised business and unsuitable advice (especially in the pensions arena) in its general push to improve consumer protection ahead of the incoming Consumer Duty. In addition, actions relating to failures in systems and controls are increasingly common, with significant penalties imposed on both companies and senior management for a range of failures.

Financial crime continues to be a priority, with the FCA utilising all powers at its disposal, including its criminal powers, successfully securing a prosecution against a large bank and imposing a substantial fine, in addition to announcing that it has charged directors who were allegedly operating a scheme to defraud investors (trial is imminent). Corporate criminal liability reforms are also being debated, though whether these will result in more actions against directors remains to be seen.

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How significant are the following risks for the directors and officers of your organisation (whether financially or reputationally)?

Regulatory breach graph



% of 'very' or 'extremely significant'

Sample: All survey participants.  
Source: 2022-2023 Directors' and Officers' Liability Insurance Survey

## Crypto climbs up the regulatory agenda

As with other jurisdictions, ESG (which will be discussed in more detail in a separate article) and crypto regulation have moved up the regulatory agenda. In the latter regard, in February 2023, HM Treasury published a [consultation paper](#) on the UK regulatory approach to cryptoassets, looking at the risks and opportunities and how the sector could be regulated. The market is still in its infancy and many concerns have been noted, not least of which is the potential use of crypto exchanges to launder money and finance sanctioned entities (the FCA is proactively applying its powers to refuse or withdraw applications for authorisations of such exchanges). Risks for D&Os will likely lie in disclosures, making sure the risks are adequately captured and reported on. There may also be risks in accepting crypto as payment, especially given its notorious volatility. In the M&A space, due diligence must be conducted carefully to understand the potential risks the company is taking on which could expose the company and its D&Os to a range of actions, including regulatory investigations.

## Regulatory reforms

Whilst the regulators are pushing forward with their regulatory agenda, at the end of 2022, the UK Chancellor, Jeremy Hunt, launched the government's "Edinburgh Reforms", which could see a shakeup of the regulatory space in the UK. Many of the reforms appear to roll back protections put in place following the global financial crisis and there will also be a review of the Senior Managers and Certification Regime, with the paper noting that the regime carries heavy compliance costs and provides a slow route to certification, which can make the UK unattractive to foreign parties. Enforcement actions under this regime have thus far been lower than expected but it is unclear whether this is due to a lack of resources to pursue actions or whether it is because the regime is effective in ensuring senior managers understand that they are accountable for their actions and, thus, this has led to a better corporate culture and less wrongdoing.

## Does the new objective encourage looser regulation?

The FCA and PRA have also been handed a new secondary objective: "to provide for a greater focus on growth and international competitiveness while maintaining their existing primary objectives". This has drawn criticism from some quarters, concerned that the objective potentially encourages looser regulation to increase competitiveness.

One can see that balancing stability and competitiveness will be a very difficult exercise for the regulators to achieve and we will have to wait and see how this plays out on a practical level and what impact it might have on the level of actions against companies and D&Os.

One other area in the UK where there was a significant expected development in regulation in 2023 was the impending arrival of the Audit, Reporting and Governance Authority (ARGA). However, the establishment of ARGA has been delayed and the FRC has instead published a new 3-Year Plan.<sup>1</sup>

1. <https://www.frc.org.uk/news/march-2023/frc-publishes-3-year-plan-showing-continued-growth>



## An overview from North America

Larry Fine and John Orr, WTW

In the US, the Securities and Exchange Commission (SEC) has also been active. While filing 760 enforcement actions and paying out \$229 million in whistleblower awards in FY 2022, the SEC has stated that "Individual accountability is a pillar of the SEC's enforcement program." The SEC has also been busy proposing new rules, including a rule which would require broad climate-related disclosures, new cyber-security rules relating to broker-dealers, clearing agencies, securities exchanges and more, and tighter regulations for SPACs. While some of the proposed rules have met delays and opposition, most of these proposals are expected to become final in some form eventually. A rule concerning "pay versus performance" disclosures concerning executive compensation did become final in 2022, while rules concerning incentive compensation clawbacks mandated by the Dodd Frank Act became final in 2023.



## An overview from Australasia

Emily Yin, WTW

Our D&O Survey highlighted a staggeringly low perception of "legal risk" for organisations across the region. New Zealand's position of being 2nd in the world and Australia's 13th position on the 2022 Corruption Perception Index could provide some explanation and context for this view, but it's also interesting to note that Regulatory/Legislative change were viewed comparatively highly and 2nd only to Cyber risks in the ratings when considering the regional outlook of business operation issues.

Company financial and operational resilience and timely company disclosures in relation to cyber incidents remain key discussion topics following significant local cyber activity and related class action filings.

2023 enforcement priorities for Australian Securities and Investments commission (ASIC) and Australian Competition and Consumer commission (ACCC) will centre around:

- Company environmental, sustainability, greenwashing claims and statements, with ASIC issuing its first greenwashing action in February 2023;

Various consumer protections relating to:

- Financial services including pricing promises associated with insurance
- Crypto assets
- Digital platforms including social media
- Essential services including energy, telecommunications and gas.



## New Zealand perspective

Robert Weaver, WTW

Key trends/developments from last year remain the focus of attention. In 2022 we expected developments in:

- FMA priorities in monitoring climate related disclosures and cyber resilience;
- the conclusion of the Law Commission review into class actions and the role of litigation funders;
- insolvencies due to the challenges posed by labour shortages, supply chain issues and increasing interest rates.

From a macro political view, there are significant changes that are likely to influence New Zealand's business and regulatory environment.

Political change has already happened with the mid-term resignation of the prime minister and further challenges lie ahead with a national election set for October 2023. This election is highly anticipated as the economy faces tough economic headwinds, but it is with this backdrop there are other political hot potatoes that the business community is closely watching, one of which is that of co-governance.

### Regulators are expected to be active through 2023, in particular the Commerce Commission

Recent evidence of this includes:

- Increased oversight of the base milk price setting regime, the introduction to the Retail Payment System Act 2022, and changes to section 36 of the Commerce Act which strengthens the prohibition on businesses taking advantage of market power, taking effect from April 2023.
- We expect new proposals to be announced around regulatory responsibilities in relation to the grocery sector, Three Waters, and consumer data rights. These issues all featured highly in the briefing to the incoming minister (of Commerce and Consumer Affairs)
- Further developments include significant changes to the Commission's Board this year as well updates to its Strategy and Vision, together with a new Statement of Intent covering the period 2023–2027.
- In 2022, the Commission expanded its strategic approach by developing its first Rautaki Māori mō Te Komihana Tauhokohoko (Rautaki Māori | Māori Strategy). We expect further details later this year and that this will form a key part of its future strategy.

The New Zealand Government is also considering a new third party claims regime that could repeal s.9 of the Law Reform Act 1936 (NZ). For directors and officers, one area that will be keenly watched is how any reform could challenge the need for a separate defence cost limit. Such reform would move New Zealand in line with most other international jurisdictions and would also reduce the complexity of D&O placements.

Regarding macro/political influence - labour supply, inflation, interest rate risks are all high on the agenda. As a smaller economy, such pressures can be acute in New Zealand. We expect to see market and political uncertainties holding back the M&A sector and capital raisings generally and these exposures, coupled with insolvencies all feature highly in the risk landscape for directors and officers. We are yet to see the D&O insurance market contract because of recessionary fears - conversely it could serve to increase competition as insurers strive to maintain premiums. Political results and how hard the economic downturn hits will weigh heavily on insurers' appetite for risk in Q4, requiring a finely balanced strategy to preserve premium pools whilst mitigating portfolio exposures.

Law Commission report and recommendations here: <https://www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC-CAL-LIF-Report%20147.pdf>



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