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COVID-19: what lessons can financial institutions learn from financial crisis litigation in the UK?

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In 2018, much was written about the changes that could be seen "10 years on" from the financial crisis, and how the financial system had been strengthened in that time. The Bank of England itself illustrated this in a graphic showing key developments, such as: significantly increased prudential requirements for banks, including as to capital requirements, leverage and liquidity; increased use of central counterparties to clear trades; launch of the Senior Managers and Certification Regime (SMCR), which requires firms to allocate clear roles and responsibilities to senior individuals, making it easier to establish individual accountability if things go wrong; and strengthening remuneration rules to better align pay with performance and discourage excessive risk-taking and misconduct.

In its graphic, the Bank of England astutely observed that "*one thing is certain: the next crisis will not look like the last one*". How right they were.

The causes of the COVID-19 pandemic and the financial crisis are very different, and the banks' ability to withstand shocks to the financial system is significantly greater today as a result of those post-financial crisis efforts. However, despite those differences, one predictable consequence from the pandemic – which was equally applicable in the financial crisis – is the litigation and regulatory action which will in all likelihood ensue.

Thankfully, many practical lessons learnt from litigation and regulatory action arising from the financial crisis can now help to inform how financial institutions approach COVID-19.

Five examples are set out below.

1. Keep good records

The wave of insolvencies during the financial crisis led to the appointment of insolvency practitioners who pursued a variety of court actions to recover assets for distribution. One of the common actions taken by the insolvency practitioners for insolvent Icelandic banks, for example, was to challenge the ISDA close-out calculations carried out by non-defaulting parties to the Icelandic banks' transactions. The close-outs in question were often carried out at times of market stress and turbulence, by teams who were extremely busy.

- When carrying out close-outs of transactions, (i) ensure that you have a clear understanding in advance of the steps you must take; and (ii) keep records of all steps taken and reasons for decisions that are made, supported by contemporaneous evidence, including screenshots of any intra-day data that may not be accessible in the future.

2. Connect the dots …

Following periods of crisis, firms may need to review their business models and adjust them for the future. However, firms may have entered into contractual arrangements – for example, in the context of joint venture agreements – which could include provisions which are triggered if the firm conducts a significant reorganisation.

- Before announcing, and implementing, any significant reorganisation, ensure that you have reviewed your critical contracts, including joint venture contracts, to identify whether any provisions will be triggered by such a reorganisation. If such provisions do exist, assess the implications of the reorganisation on the contract(s) in questions, then ensure management is fully briefed so those implications are taken into account when making decisions about the reorganisation.

3. … and then connect the dots a bit more

In times of crisis, the pressure to generate returns may be a powerful driver. Individuals who are stretched may cut corners, or simply fail to assimilate critical information. In these situations, staff who notice that mistakes are being made, or that bad behaviour may be occurring, are encouraged to raise their concerns, including by whistleblowing.

When the Financial Conduct Authority's (FCA) whistleblowing rules were published in 2015 (which was itself another follow-up step from the financial crisis), the FCA was clear as to the importance of whistleblowers in exposing poor practice, and stressed that it was in the interests of the industry and regulators alike that wrongdoing was identified and addressed promptly. Although firms now have in place the required whistleblowing arrangements, one aspect bears emphasis in today's circumstances.

- In order to pinpoint areas where problems may be emerging, a firm's whistleblowing framework must have the ability to take an overview of the information which is coming in – to "join the dots" between what may, at first sight, look like different issues in different places. This can make all the difference, enabling firms to catch potentially widespread issues at an early stage and take prompt pre-emptive action to address the causes of the issues and remedy them before they become too serious.

4. Think for yourself

Time and again, individuals accused of misbehaviour have argued that everyone is doing it – that this is the way the market works. Regulators and criminal authorities have consistently given short shrift to this argument.

- It is of critical importance that individuals think for themselves, and act appropriately. The fact that others are behaving in a particular way does not mean that it is an acceptable way to behave.

5. The regulatory reach is longer than you might think

Two of the biggest sets of enforcement actions in recent years – in relation to LIBOR and FX – concerned areas of business which were unregulated[1] at the time of the events which led to the enforcement action. As is well known, the FCA instead based its enforcement findings on breaches of the Principles for Businesses.

- Even if the issue that a firm or individual is facing has arisen in an unregulated area, the FCA is likely to be able to frame an action against a firm around breach of the Principles, or take action against relevant Senior Managers under the SMCR. It should therefore be reinforced with staff – no matter whether the business they work in is regulated or unregulated – that compliance with the Principles, and "doing the right thing" is absolutely critical at all times.

Next steps

Our Financial Services Litigation and Investigations Practice has extensive experience advising major banks and financial institutions on a wide range of issues arising from the financial crisis, including in litigation and on the highest profile investigations of the time, such as the Libor investigations and follow-on litigation and FX benchmark manipulation.

We would be pleased to assist you with any COVID-19 issues that you are facing. Please get in touch with your usual Hogan Lovells contact if you would like to discuss any of the matters covered in this briefing.

We are following developments in respect of COVID-19 very closely, so please visit our dedicated page here to stay on top of this constantly evolving situation.

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[1] At the time, the submission to, and administration of, LIBOR were unregulated, and the spot FX market was unregulated.

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