
A Work in Progress: The Legal Function and the FCA's Senior Managers' Regime

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The Senior Managers and Certification Regime (the "Regime") came into force on 7 March 2016, with the stated aim of enhancing and embedding a culture of individual responsibility and accountability within the UK's banking sector. There has, however, been some confusion and concern within the banking sector, the legal profession and the regulator as to the applicability of the Regime to a firm's legal function.

In light of industry-wide uncertainty, the FCA felt compelled to publish a Clarifying Statement¹ in January and a subsequent Discussion Paper² in September this year. Whilst acknowledging the uncertainty and stating its intention to consult on the issue, the FCA made clear its view that the legal function is included within the Regime. The FCA also confirmed, however, that any firm that has made a decision, in good faith, not to include the person in charge of the legal function as a Senior Management Function ("SMF"), need not change their approach in the interim.

The Discussion Paper outlines the policy arguments for and against designating the head of the legal function as a SMF and invites submissions on the merits of both. The arguments against inclusion are interrelated and reflect those voiced by the Law Society³ and banking industry bodies such as the British Bankers Association and the Association for Financial Markets in Europe.⁴

First, if the head of the legal function is a solicitor or a barrister, they are already subject to professional conduct regulations imposed by the Solicitors Regulation Authority ("SRA") or the Bar Standards Board respectively. Including the legal function, it is suggested, would double the regulatory burden and also put at risk the in-house lawyer's existing professional obligations, most notably that they must not allow their independence to be compromised.

Second, the head of legal performs a crucial independent advisory function. This includes counselling a firm and its senior management on legal risk and, increasingly frequently, carrying out internal investigations. It is argued that including the legal function as a SMF could place a lawyer's interests in conflict with those of their employer. Were the FCA to bring a personal enforcement action, the head of legal would be compelled to protect their personal interests under the Regime whilst also being obliged to act in the best interests of the firm. As a result, their ability and willingness to provide independent advice may be compromised.

Third, legal professional privilege (“LPP”) may be prejudiced. If the head of legal needed to demonstrate that reasonable steps had been taken in their performance of a SMF, it may be that the only practical and meaningful way to do so would be to rely on material benefiting from LPP. In addition to undermining a fundamental protection, this could place the lawyer in an awkward position as any LPP pertaining to communications made by the lawyer would belong to the bank and it would be for the bank alone to elect to waive it.

The Discussion Paper advances counterarguments to each of these concerns, some more compelling than others.

First, far from doubling the regulatory burden on solicitors, the FCA’s Individual Conduct Rules and Senior Manager Conduct Rules are consistent with, and largely mirror, the SRA’s Principles.

Second, the FCA makes clear that there is no requirement for the General Counsel, or indeed any other lawyer, to be allocated overall responsibility for the legal function. Such responsibility may, for example, be lodged in another department, such as compliance; or the most suitable person to have overall responsibility for the legal function may, for example, be the CEO or another of the firm’s directors. Firms retain complete discretion as to who should be allocated responsibility.

Third, the FCA contends that it is the management of the legal function, i.e. the provision of training, internal controls and allocation of resources, that brings it within the Regime rather than the provision or accuracy of specific legal advice. In addition, section 413 of FSMA 2000 - the statute from which the FCA derives its mandate – prevents the FCA requiring the disclosure of material benefiting from LPP, thus ensuring that the Regime does not and cannot operate to undermine LPP. It is suggested that the FCA can accurately supervise a firm’s legal function without recourse to material benefiting from LPP.

Firms will be slow to take much comfort from such assertions, however, particularly in light of the FCA’s recently published draft guidance on the duty of responsibility.⁵ This makes clear that, when determining whether a senior manager has taken reasonable steps, the FCA will have regard to, amongst other factors: whether the manager exercised reasonable care when considering the information available to them; and whether the manager reached a reasonable conclusion on which to act. It would seem inevitable that such considerations will go to the substance, as well as the form, of any legal decision making. As the FCA acknowledges in its Discussion Paper, firms are likely to continue to demand that the Regime recognises, explicitly, the protected status of information benefiting from LPP, in much the same way that the Conduct Rules do.⁶

The FCA’s deadline for receipt of responses to the Discussion Paper is 9 January 2017. Should the FCA decide to pursue further policy proposals to address this issue, it will issue a Consultation Paper in due course. The banking industry and the legal profession remain eager to learn how the regulator intends to reconcile the demands of the head of the in-house legal function with those of the Regime.

¹ <https://www.fca.org.uk/news/statements/clarifying-our-supervisory-intentions-overall-responsibility-legal-function-under>

² <https://www.fca.org.uk/publications/discussion-papers/overall-responsibility-and-legal-function>

³ <https://www.lawsociety.org.uk/news/press-releases/risk-of-conflict-of-interest-if-legal-function-is-included-in-smr/>

⁴ file:///C:/Users/28819/Downloads/BBA01-%23461797-v1-BBA_AFME_letter_to_FCA_re_role_o_GC_in_SMR_pdf%20(2).pdf

⁵ <https://www.fca.org.uk/sites/default/files/cp16-26.pdf>

⁶ FCA Handbook, COCON 4.1.12G

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