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## UK Government Sets Date for New Regulatory Regime

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The UK government announced on Tuesday, 3 March 2015 that the new financial regulatory regime, which creates tougher rules for Britain's senior bankers, will come into force on 7 March 2016.

### Background

The UK Financial Conduct Authority ("FCA") has for some time declared itself committed to holding members of senior management to account and to pursuing more cases against individuals. It has historically encountered evidential hurdles in establishing personal culpability, as illustrated by its 2012 defeat in the case of UBS banker John Pottage. The Financial Services (Banking Reform) Act 2013 ("the Act") has introduced a number of important changes to the UK financial regulatory regime, many of which are aimed at overcoming those hurdles. This alert provides a brief overview of the key changes on the horizon.

### Application

The new regime will apply to all UK-incorporated banks, building societies, credit unions and investment banks. It will also cover UK branches of foreign firms.

### A Presumption of Guilt

A key feature of the new regime is a reversal of the burden of proof in relation to senior managers, who may now be subject to enforcement action if a breach occurs in an area for which they were responsible at the time, *unless* they can demonstrate that they took all reasonable steps to avoid the breach. For the first time, the burden is on the individual to rebut a presumption of guilt. Along with the recent extension of the FCA's limitation period in respect of misconduct<sup>1</sup> cases, this will make it far easier for the FCA to bring and win actions against senior individuals.

Individuals performing a "senior management function" ("SMF") will require regulatory pre-approval by either the FCA or the Prudential Regulation Authority ("PRA"), depending on the nature of the function in question. It is envisaged that individuals who are already authorised as approved persons and who fall within the scope of the senior managers regime will be "grandfathered," meaning that they will not need to obtain further approval to perform the equivalent SMF.

Although the new SMF is designed to capture a smaller population than the existing "significant

influence function", there is nevertheless a substantial list of key functions to which it will apply. These include board members, executive committee members, the heads of key business areas, the heads of key control functions and anyone performing a "significant responsibility" SMF. Broadly speaking, a function will be a significant responsibility SMF if responsibility for it has been delegated by the Board of Directors and the person performing it is accountable to the Board in respect of it. The regime will also cover the non-executive roles of Chairman, Senior Independent Director and the chairs of the Risk, Audit, Remuneration and Nominations Committees.

Firms have until 8 February 2016 to notify the regulators of the names of their senior staff who will be designated as senior managers under the new regime.

### **Statements of Responsibilities**

All applications for regulatory approval in respect of senior management functions will have to be accompanied by a "statement of responsibilities", and firms will be required to notify the FCA whenever there are significant changes to those responsibilities. There will also be a requirement for handover certificates to be prepared by any senior manager relinquishing their role, describing how they have met their responsibilities and identifying any areas of vulnerability. In bringing enforcement action, the FCA will undoubtedly rely on those statements and certificates as evidence of what individuals were aware of and signed up to.

### **The Certification of Employees**

Firms will be required to implement a certification regime for employees who are not senior managers but who perform a function considered to involve a risk of significant harm to the firm or its customers. This will cover a broader group of individuals than the existing approved persons regime. Firms themselves will be responsible for certifying, on an annual basis, that these individuals are "fit and proper" to perform their role.

### **A New Set of Rules**

New "Conduct Rules" are to be issued by both the FCA and PRA, to replace the existing Statements of Principle and Code of Practice for Approved Persons. The two sets of rules are expected broadly to reflect each other and to draw upon the existing standards. However, the FCA's new rules will apply not only to senior managers and certified employees but also to all other employees of relevant firms unless they carry out a purely ancillary role (for example administrative staff). This represents a significant extension of the FCA's remit.

### **A New Criminal Offence**

Also from 7 March 2016, it will be a criminal offence for a senior manager of a financial institution to take (or agree to the taking of) a decision, or fail to take steps to prevent the taking of a decision, which when implemented causes the institution to fail. The new criminal offence applies only to senior managers in UK-incorporated banks and investment banks. Unlike the other features of the senior managers regime, it cannot be extended to non-UK firms.

The offence was introduced following a recommendation by the Parliamentary commission on

banking standards, which found that "regulatory authorities seemed almost powerless to bring sanctions against those who presided over massive failures within banks". However, in reality the new offence will be very difficult to prosecute. Not only is liability severely limited by the required mental element (the senior manager must have been aware at the time that the relevant decision may cause the institution's failure) but the relevant threshold—the failure of the institution—is very high. Causation will also be a substantial hurdle to overcome—it is difficult to imagine many cases, if any, where it will be possible to prove that the implementation of a single decision has caused the failure of an institution.

### **Implications of The New Regime**

While the new criminal offence relating to the failure of a bank may have caused some unease in the financial sector, in reality it will do little to change the enforcement landscape. In contrast, the new regulatory measures will represent a significant additional burden for firms and will leave senior managers considerably more vulnerable to enforcement action in their personal capacity. Given the likelihood that the new "statements of responsibilities" will be used to assist the FCA in enforcement action, they will need to be drafted with care and legal advice sought as appropriate. Armed with signed job descriptions and divested of its burden of proof, we should expect the FCA to apply itself with renewed vigour to the task of holding senior individuals to account.

<sup>1</sup> In respect of misconduct occurring on or after 25 July 2014, the extension of the limitation period for disciplinary action by regulators against individuals has been increased from three to six years. The extension also applies in cases of disciplinary action against individuals for performing a controlled function without approval.