

The UK Senior Managers Regime: One Year Later

Law360, New York (March 3, 2017, 12:29 PM EST) –

On March 7, 2017, it will be one year since the U.K. Financial Conduct Authority's senior managers and certification regime came into force, heralding a new era of personal accountability in the financial sector.

A central feature of the SMCR — which currently applies to banks and insurers but is due to be extended to all financial services firms next year — is a new statutory "duty of responsibility." In force since May 2016, the new duty makes those holding a "senior management function" liable to enforcement action if a breach occurs on their watch. While the FCA, like its predecessor, has long declared itself committed to holding members of senior management to account and to pursuing more cases against individuals, establishing personal culpability for oversight failings has historically been an uphill struggle — as illustrated in 2012 by the then FSA's defeat in the case of UBS banker John Pottage. The introduction of the new regime set out to make such hurdles a thing of the past.

Since the duty of responsibility does not apply retrospectively, it is likely to be some time before the Upper Tribunal has the opportunity to rule on its scope and application. In the meantime, this article looks at some features of the regulatory enforcement landscape that may lie ahead.

More Cases Will Be Contested

As Mark Steward, the FCA's director of enforcement, acknowledged in a speech on Jan.19, it is likely in due course that we will see more cases being contested before the Upper Tribunal — not just on the part of individual senior managers, who are by nature less likely than corporate entities to want to resolve cases by agreement, but also by their employers.

For firms subject to enforcement action for the alleged failings of their senior managers, the decision whether to settle or contest an enforcement action is likely to become more finely balanced. Settlement undoubtedly offers a number of potential benefits to firms: a degree of certainty; the opportunity to prepare for and manage the associated reputational damage; and the avoidance of costly litigation potentially resulting in an adverse finding. However, in cases where enforcement action against the firm's senior managers is likely to follow and will almost certainly be contested, firms may take the view that the benefits of settlement are significantly reduced. On the other hand, where the facts of a particular case weigh in favor of settlement, we may see firms cutting their senior managers loose at a relatively early stage in the process so that they can enter the settlement process unencumbered.



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There Will Be More Scope for Tension Between Firms and Their Senior Managers

Senior managers subject to enforcement action for breach of the new statutory duty may find themselves having to strike a difficult balance between seeking to exploit any inaccuracies in their statement of responsibilities and maintaining a professional relationship with their employer. We are also likely to see more protracted negotiations around employment contracts and exit terms, in an environment where the state of the business that an employee is inheriting or handing over — and the precise limits of their responsibility — have suddenly assumed a far greater significance.

In a similar vein, the new rules on regulatory references — a mandatory form of employment reference designed to prevent the "recycling" between firms of individuals with poor conduct records — come into force on March 7, 2017. Where firms are recruiting into certain key roles, there is now a significant burden on them to seek references from previous employers in the last six years as well as to provide references in response to requests from authorized firms. In some cases firms will be required proactively to update their references where new relevant information comes to light, potentially without the former employee being afforded the means to test that information in a meaningful way. Given that firms on the receiving end of references will be obliged to take them into account when assessing fitness and propriety, the potential for disputes in this area has undoubtedly increased.

"Reasonable Steps" Will Become a Key Concept in Enforcement Actions

The FCA can now take action against a senior manager where there has been a contravention by the firm; the senior manager was responsible for the management of any of the firm's activities in relation to which the contravention occurred; and the senior manager did not take reasonable steps to avoid the contravention. Although the burden is on the FCA to prove that reasonable steps were not taken (the controversial reversed burden of proof having been abandoned in 2015), in practice any senior manager subject to an enforcement action will need to produce detailed evidence of the reasonable steps they took.

In September last year the FCA issued guidance on the operation of the duty of responsibility. The consultation on it has now closed and final guidance is expected to be published soon. While the guidance will be of some assistance to senior managers wishing to limit their exposure, it is predictably high-level and noncommittal. By way of example, the FCA has expressly declined to include guidance on the management of "competing priorities," among other things "to avoid giving the impression that Senior Managers will not be guilty of misconduct under the duty of responsibility merely by demonstrating that they were faced with competing priorities, or that it is acceptable for a busy Senior Manager to deprioritize concerns about conduct." While it would be absurd to suggest that a senior manager could avoid liability simply by demonstrating a busy schedule, competing priorities are nevertheless a reality and in appropriate cases may well be relevant to whether or not a person has taken reasonable steps to avoid a contravention. Senior managers will be playing close attention to enforcement actions of this type, and in the meantime should ensure that they have processes in place for documenting actions that they may need to rely on in the future.

The FCA will Test the Water with Low-Hanging Fruit

Despite the anticipation with which we await the FCA's first enforcement actions under the SMCR, it is unlikely that they will be particularly instructive in terms of how the duty of responsibility will be applied. The regime came into force a year ago amid much clamor that it signaled a significant addition to the FCA's powers and a turning point with respect to enforcement against individuals. It would be surprising, in those circumstances, if the FCA chose as its test actions anything but the most straightforward of cases where the breaches were relatively clear and uncontroversial. Not only will the FCA be looking to get some decisions under its belt to complement the guidance, but to fail at the first hurdle would be a reputational disaster. It will probably not be until the subject of an enforcement action challenges the attribution of responsibility before the Upper Tribunal that the SMCR will be tested in any meaningful way.

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