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Senior Managers at Financial Institutions now Face Potential Personal Liability for Regulatory and Criminal Wrongs. Here is How to Avoid That.

This article examines the increasing importance of the Senior Managers and Certification Regime (“SMCR”). The SMCR is a regulation implemented in November 2019 by the Financial Services Authority (“FCA”). It was conceived to address the inadequacies of the old UK Approved Persons Regime (“APR”) in the aftermath of the 2007-2008 financial crisis. In particular, legislators sought to move away from collective responsibility and instead hold individuals in the banking sector personally accountable for their firm’s failings¹.

To this end, the SMCR empowers the FCA and Prudential Regulation Authority (“PRA”) to take enforcement action against Senior Managers personally, both by way of regulatory and criminal proceedings.

Since the SMCR came into force on 7 March 2016, its reach has been extended twice. The SMCR now applies to banks, building societies, PRA-designated investment firms, insurers and, as of December 2019, all FCA-only regulated firms (so called ‘solo-regulated firms’), including mortgage brokers and consumer credit firms.

At the time of writing, the UK is, once again, experiencing considerable economic turmoil, this time precipitated by the COVID-19 pandemic. Hence, the stage is set for the FCA and PRA to utilise their impressive arsenal of enforcement powers under the SMCR to full effect. The FCA issued a stark warning to this effect in the third week of the UK’s first nationwide lockdown:

“We will remain vigilant to potential misconduct. There may be some who see these times as an opportunity for poor behaviour – including market abuse, capitalising on investors’ concerns, or renegeing on commitments to consumers. Where we find poor practice, we will clamp down with all relevant force”².

Accordingly, Senior Managers of FCA and PRA-regulated firms must prepare themselves for imminent enforcement action under the SMCR.

This article focuses on two enforcement actions available to regulators, one civil and one criminal, with an emphasis on steps to be taken by Senior Managers to mitigate the risk of sanctions, including large fines and lengthy terms of imprisonment.

Overview of the SMCR

The SMCR comprises: (1) the Senior Managers Regime (“SMR”); (2) the Certification Regime; and (3) the Conduct Rules:

- (a) The SMR. The SMR concerns the performance of Senior Management Functions (“SMF” or “SMFs”), by FCA-designated Senior Managers³ on behalf of their firms. SMFs are

¹ For further background, see Parliamentary Commission in Banking Standards. (2013), *Changing Banking for Good*. Available: <https://publications.parliament.uk/pa/jt201314/jtselect/jtpebs/27/2703.htm>. Last accessed on 18th September 2020.

² FCA. (2020). *FCA Business Plan 2020/21*. Available: <https://www.fca.org.uk/publication/business-plans/business-plan-2020-21.pdf>. Last accessed 20th September 2020.

³ Approved under section 59 FSMA.

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controlled functions under the Financial Services and Markets Act 2000 (“FSMA”). A function is a SMF where the authorised person is responsible for taking decisions, or participating in the taking of decisions, aspects of which involve, or might involve, a risk of serious consequence for the authorised person, or for the business or other interests of the UK⁴. Common SMFs include the roles of executive director of a regulated firm or being responsible for overseeing a firm's compliance against money laundering⁵. The SMCR has extraterritorial application, and therefore, the SMR applies to approved Senior Managers based in the UK and overseas. Before a person can perform any SMF, an application must be submitted to and approved by the relevant regulator. It is then a matter for the regulator to assess the applicant’s fitness and propriety (hereafter “F&P”) to perform the SMF(s). Firms are required to certify that their Senior Managers continue to remain suitable to perform their SMF⁶ on an annual basis.

- (b) Certification Regime. Certification staff are those employees who do not carry out SMFs, but whose roles pose the potential to cause significant harm to the firm’s operations, its customers, or the market more generally (e.g. investment managers). In a notable departure from the APR, firms are solely responsible for certifying that these members of staff are F&P to perform their roles from the point at which they are employed, and annually thereafter. Firms ought to have regard to the indicators of F&P published on the FCA’s website when carrying out these assessments⁷.
- (c) Conduct Rules. The FCA and PRA Conduct Rules, as set out under the joint Code of Conduct (“the Code”), detail the core standards of behaviour expected of those engaged in regulated and unregulated financial services activities. The rules apply to all but “ancillary” staff⁸ and principally require that they act with integrity, due skill, care, and diligence, be open and cooperative with their respective regulator, treat customers fairly and observe proper standards of market conduct. Further, there are additional conduct rules applicable to Senior Managers.

Senior Managers May be Found in Breach of their Duty of Responsibility

Senior Managers can face enforcement action for regulatory failings in the areas of their firm’s activities they are responsible for. Where a Senior Manager has been found to have breached their duty of responsibility, they are guilty of misconduct⁹. Section 66 FSMA provides that Senior Managers may be punished by way of a financial penalty; suspension; the imposition of conditions on their approval; and/or public censure. Senior Managers should be aware that the protection usually afforded by indemnities and Directors and Officers insurance is not available in the case of a fine imposed on them personally by the FCA¹⁰.

⁴ Section 59ZA FSMA. The function is a description specified in rules made by the FCA under section 59(3) FSMA which is designated as a SMF by the FCA under section 59(6A), or the PRA under section 59(3)(a) FSMA.

⁵ FCA. (2019). *Senior management functions*. Available: <https://www.fca.org.uk/firms/approved-persons/controlled-functions>. Last accessed 18th September 2020.

⁶ Or each SMF, as the case may be.

⁷ FCA. (2020). *Senior Managers and Certification Regime: solo-regulated firms*. Available: <https://www.fca.org.uk/firms/senior-managers-certification-regime/solo-regulated-firms>. Last accessed 18th September 2020.

⁸ Cleaners, receptionists, and security staff for example.

⁹ Sections 66A(5) and 66B(5) FSMA.

¹⁰ The FCA Handbook and public policy prohibits this to ensure the deterrent effect of the financial penalty.

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In order to be found liable for misconduct, the relevant regulator bears the burden of proving the following:

- (i) a relevant requirement has been or is being breached;
- (ii) the Senior Manager was responsible for the management of activities in their firm connected to the breach; and
- (iii) the Senior Manager did not take such steps as a person (i.e. a competent SMF manager) in their position could reasonably be expected to take to avoid the breach.

In addressing points (ii) and (iii), regulators largely rely on a document titled a 'Statement of Responsibility'. This document details specific aspects of the firm's affairs that the Senior Manager has undertaken to be accountable for when performing their SMF(s)¹¹. The Statement(s) of Responsibility must be submitted by firms to the relevant regulator as part of the Senior Manager approval process. Further, other documents such as organisational charts¹², emails and minutes of meetings¹³ will be examined by the relevant regulator to demonstrate the extent of a Senior Manager's responsibilities.

Both regulators¹⁴ have published non-exhaustive guidance addressing factors they consider to be relevant when assessing whether reasonable steps have been taken by Senior Managers. Common considerations between the regulators include whether:

- the Senior Manager had knowledge of and fully understood their firm's activities, including regulatory concerns relating to their role and responsibilities;
- an alternative course of action could have been taken;
- delegation of responsibilities was itself reasonable (ii) to an appropriate person and (iii) overseen effectively;
- the Senior Manager ensured that reporting lines, whether in the UK or overseas, in relation to the activities they were responsible for, were clear to staff and operated effectively;
- the Senior Manager has been the subject of a previous investigation; and
- the Senior Manager took reasonable steps to ensure an orderly transition when they were replaced in the performance of their function by someone else.

Where decisions have been taken collectively (e.g. during a committee attended by more than one Senior Manager and standard non-executive directors) the FCA will analyse the extent to which the Senior Manager in question:

- (i) informed themselves of the relevant matters before taking part in the discussion; and
- (ii) exercised reasonable care, skill and diligence in contributing to the decision¹⁵.

¹¹ Section 60(2A) FSMA.

¹² For instance, Responsibilities Maps submitted by Enhanced Firms.

¹³ See DEPP 6.2.9CG.

¹⁴ FCA: DEPP 6.2.9-CG and DEPP 6.2.9-EG; PRA: Chapter 2 of SS28/15 and SS35/15.

¹⁵ DEPP 6.2.9E(15).



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In order to minimise the likelihood of being found in breach of their duty of responsibility, a prudent Senior Manager would take measures, inclusive of, but not limited to the following, to evidence the scope of their responsibilities and the steps they took to avoid a breach:

Statement of Responsibility

1. Carefully scrutinise your Statement(s) of Responsibility before commencing your role(s).
2. Consider wider documentation accompanying your job description and Statement(s) of Responsibility (e.g. organisational charts) to fully appreciate the context of the activities you are being tasked with managing on your firm's behalf.
3. If you are concerned that your Statement of Responsibility encompasses responsibilities falling outside your knowledge or competency, challenge it and seek appropriate amendments.
4. If unsure about the scope of your responsibilities or the wider context of the firm's governance, organisational or compliance structure within which you are due to exercise your SMF, seek clarification. If still in doubt, seek independent legal advice.

Wider relevant documentation

1. Ensure that you fully understand your position within the firm's management responsibilities map.
2. Ensure, so far as reasonably practicable, that minutes of meetings and emails accurately reflect (i) the scope of your firm's activities you are responsible for (ii) the extent of the information that is available to you; and (iii) steps you have taken to address concerns and/or failings.
3. Routinely keep records of high-risk developments. This includes noting the circumstances in which you became aware of a regulatory concern arising connected with your role and responsibilities and the steps you took to address these (e.g. delegation to others and the oversight you exercised).

Senior Managers may be Guilty of a Criminal Offence relating to a Decision Causing a Financial Institution to Fail

A Senior Manager may be prosecuted under section 36 of The Financial Services (Banking Reform) Act 2013 where they have been involved in the making of a decision causing the failure of a financial institution. Criminal proceedings can be instituted in England and Wales by the FCA and PRA or the Secretary of State, or by or with the consent of the Director of Public Prosecutions¹⁶. Senior Managers of UK banks, building societies and PRA-designated investment firms are all vulnerable to prosecution¹⁷.

The elements of the offence can be summarised as follows:

¹⁶ Section 38 The Financial Services (Banking Reform) Act 2013.

¹⁷ Insurers and Credit Unions are not caught by the offence: section 37(2)(b) The Financial Services (Banking Reform) Act 2013.

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- (i) the Senior Manager takes, or agrees to the taking of, a decision by or on behalf of a UK financial institution as to the way in which the business of the group institution¹⁸ is to be carried on; or
- (ii) the Senior Manager fails to take steps to prevent such a decision being taken; and
- (iii) at the time of the decision, the Senior Manager is aware of a risk that the implementation of the decision may cause the failure of the group institution; and
- (iv) in all the circumstances, the Senior Manager's conduct in relation to the taking of the decision falls far below what could reasonably be expected of a person in their position; and
- (v) the implementation of the decision causes the failure of the group institution.

A financial institution is regarded as 'failing' where it enters insolvency¹⁹, any of the stabilisation options in Part 1 of the Banking Act 2009 is achieved in relation to the financial institution, or it is taken for the purposes of the Financial Services Compensation Scheme to be unable, or likely to be unable, to satisfy claims against it²⁰.

The offence is punishable on summary conviction to a maximum of six months' imprisonment or a fine or both, and on conviction on indictment, to a maximum term of seven years' imprisonment or a fine or both²¹.

The distinct absence of prosecutions for this offence in the past four years is no doubt due to the inherent difficulty of establishing causation. For liability to attach to the Senior Manager's actions, or inaction, as the case may be, it must be proven that (i) the decision the Senior Manager took/agreed to taking or (ii) the decision taken by others (in relation to which the Senior Manager failed to take steps to prevent) caused the failure of the financial institution. It goes without saying that several factors typically lead to a financial institution failing, with no one decision being the sole cause.

Despite the obstacle causation provides to securing a conviction, senior managers should take steps to mitigate the risk of conviction, such as the following:

1. Should your financial institution be on the verge of failing, take time to ensure that:
 - 1.1. your decision making is sound;
 - 1.2. the decision you are agreeing to is appropriate; and/or
 - 1.3. you respond appropriately to the decisions of others.
2. Retain any documentation or otherwise make a contemporaneous note of the factors threatening the ongoing success of your firm, with reference to the indicators of failure at section 37(9) of The Financial Services (Banking Reform) Act 2013.
3. Retain any documentation to evidence the extent of your knowledge concerning the financial position of your firm and the risks (if any) you were aware of in connection with decisions to be taken.

¹⁸ Any other financial institution that is a member of the firm's group for the purposes of FSMA with reference to section 421 of FSMA; section 36(2) The Financial Services (Banking Reform) Act 2013.

¹⁹ See section 37(10) The Financial Services (Banking Reform) Act 2013.

²⁰ Section 37(9) The Financial Services (Banking Reform) Act 2013.

²¹ Section 36(4) The Financial Services (Banking Reform) Act 2013.

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4. Ensure that your contributions and responses to internal discussions on decision-making are accurately recorded in meeting minutes, emails, and other documentation so you can evidence your conduct.

In conclusion, as regulatory and legislative pressure builds on financial institutions in the wake of financial crises, Senior Managers in those institutions increasingly must be alive to their potential personal liability for institutional failings. This article has provided a road map as to how to work towards ensuring that you adhere to the current regulatory and legislative regimes in order to minimise the likelihood of being found in breach.



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With a practice built upon a strong foundation of criminal advocacy, and encompassing parallel civil and regulatory proceedings, Racheal's knowledge and experience of Commercial Crime and Financial Regulation far exceeds her call.

Over the past five years, Racheal has defended individuals and corporates against White Collar Crime prosecutions for charges including: Fraud, Proceeds of Crime Act 2002 (POCA), Bribery and Corruption in the Crown and Magistrates' courts. Further, she has advised her clients in anticipation of litigation, including a client who instructed Racheal to examine the extent of their potential corporate criminal liability while a junior on the Grenfell Inquiry.

When defending corporates and individuals, Racheal draws upon her direct insight into the unique ways in which criminal and regulatory investigations are conducted at the Serious Fraud Office (SFO) and Financial Conduct Authority (FCA).

Racheal has considerable experience of SFO lead investigations and Deferred Prosecution Agreement (DPA) negotiations. She has been seconded to four separate case teams where she has advised extensively on disclosure and legal professional privilege (LPP). Further, Racheal currently assists the SFO as Lead Disclosure Counsel on an ongoing high profile SFO investigation.

Throughout 2019, Racheal was seconded to the FCA's Criminal Prosecution Team (CPT), the Retail section of the Enforcement and Market Oversight Department (EMO) and the Threshold



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Conditions Team (TCT). While an Associate within CPT, Racheal expedited POCA proceedings and drafted the FCA's internal practice manual on Prosecuting Corporates. Further, Racheal was appointed as the Principal Investigator within EMO on a £60M deferred benefit pension transfer advice regulatory investigation.

For further guidance, please contact the 36 Commercial Crime and Regulation team by calling +44 (0)20 7421 8051 or emailing clerks@36commercial.co.uk