Strengthening accountability in banking

BSA response to FCA CP 16/26: Duty of responsibility

3 January 2017

Building Societies Association

Introduction

This response supports the proposals in, and comments on, FCA CP 16/26, which consults on guidance on how the FCA will enforce the 'duty of responsibility', which is now in force under the Bank of England and Financial Services Act 2016.

The BSA consistently opposed the proposal of a presumption of responsibility and is pleased that this fundamentally unfair concept was replaced by a duty of responsibility, with the burden of proof where it should be; ie on the regulator.

Irrespective of the complexity of the overall legal and regulatory picture, what we would like to see from the regulators is a consistent approach to the application and interpretation of 'reasonable steps'. We recognise that achieving such an approach has been extremely difficult in the past, but going forward the key will be fair, proportionate and consistent enforcement against firms and individuals as appropriate.

It would also be very helpful if, once any teething problems in the SM&CR rules have been remedied or clarified, the regulators would allow a prolonged period for the new regime to bed down, before proposing any more substantive changes. A degree of consistency, generally absent in relevant law and regulation for about two decades, would greatly help consumers, firms and the economy.

Responsibility going forward

1. Directors and senior managers in financial services firms are subject to a wide range of 'horizontal' and 'vertical' requirements relating to their conduct, deriving from statute, common law and regulatory rules. A tabular overview for our sector, which we recently provided to our members is as follows –

NB: there is significant overlap in some of the areas below

General Law *(statutory and case law)*	*Building Societies Act 1986*	*Regulatory* *(financial services)*
Fiduciary duties – i.e. duties of trust: e.g. good faith, no conflicts of interest etc. **Care and skill** – as is reasonable to expect given the role – there is both a subjective and an objective element to this duty Further specific duties are imposed on directors and others by **other laws** e.g. in relation to health and safety, data protection, competition etc. *Note: the Companies Act 2006 codified the duties for **company** directors*	**Individual duties** – the anti-conflicts of interest provisions e.g. transactions with the society, loans, commission etc. **Collective Responsibilities** – e.g. compliance with principal purpose and nature limits, restrictions on powers etc. *Credit unions have their own legislation as well*	Duties largely underpinned by FCA and PRA provisions – 1. **'knowingly concerned'** in a regulatory breach 2. breach of a **conduct rule** 3. breach of the new **'duty of responsibility'** 4. criminal liability under **'reckless management'** causing a firm to fail

Also note: *the UK Corporate Governance Code*

2. As is evident from the table, the duty of responsibility is only one part of a very broad picture. There is also an added complexity when a regulator supervises against Rules but enforces against Principles, which is something that has happened in the past. In paragraphs 1.10 and 2.6, CP16/26 helpfully acknowledges some of the various moving parts and the inter-linking between them. Items 1-3 in the third column are likely to overlap and it is by no means clear that it is really necessary or logical to have three separate provisions, but we accept that this is now the position and that firms must work with it. For example, the duty of responsibility is likely to overlap considerably with some of the conduct rules in practice; especially no 2 (compliance) but also others in certain cases.

3. It would be very helpful if, going forward and once any teething problems or issues in the SM&CR rules have been remedied or clarified, the regulators would allow a prolonged period for the new regime to bed down, before proposing any more substantive changes. We reluctantly acknowledge that a move towards genuinely simpler consumer laws and rules may - at best - be some way off. However, a degree of consistency, generally absent in relevant law, regulation and regulatory structures for nearly two decades, would greatly help consumers, firms and the economy. Where rules and laws are properly thought out in advance, rather than simply representing a reaction to episodes of misconduct, there should be less need for amendment. Consistency would also help everyone concerned, including the general public as well as businesses, to gain a proper and lasting appreciation of the rights and responsibilities. These are principles that we believe should be at the heart of the FCA's Mission and, later this month, we will elaborate on our views in our response to that separate consultation.

4. We have made two key points to our members in this context, both of which we believe to be constructive. First, that the legal and regulatory requirements for individuals broadly align with the expectations on firms – for example, much of the content of the duty of responsibility and, indeed, the conduct rules align with the requirements in the FCA's Principles for Business and the PRA's Fundamental Rules. Therefore, firms and individuals within them are very much "in it together" when it comes to strong prudential management and fair treatment of customers.

5. Second, generally speaking, 'reasonable steps' is both a mitigant and a defence for individuals in most cases of potential liability. Therefore, irrespective of the complexity of the overall legal and regulatory picture, what we would like to see from the regulators is a consistent approach to the application and interpretation of 'reasonable steps'. Between 2013 and 2015, approximately 90% of the total conduct fines (in amount) were levied on ten large firms [1]. However, there was a striking lack of sanctions against individual senior managers in those firms – the vast majority of such sanctions being against relatively junior staff such as market traders or senior managers in smaller firms.

6. The FCA has stated that a problem in the past regarding enforcement against individuals was "*the lack of clarity within firms about who held responsibility for failures within firms, which meant that individuals could not be held to account*" [2]. Since the introduction of statements of responsibility and responsibilities maps earlier this year, opacity of governance arrangements can no longer be put forward as a reason not to enforce regulatory requirements against relevant individuals, even in the largest, most complex organisations. Going forward, the key will be fair, consistent and proportionate enforcement against firms and individuals as appropriate, including senior individuals at very large firms.

7. Before looking specifically at Appendix 1 to the CP and 'reasonable steps, we have a few specific comments - all generally supportive - on matters raised in body of the CP –

- all BSA members are dual-regulated, so we strongly welcome the confirmation set out in paragraph 2.5, that the two regulators worked closely together to ensure that their respective guidance on the duty of responsibility aligned. While we appreciate that the PRA and the FCA will be dealing with different practical situations, their underlying guidance about good conduct should be as consistent as reasonably possible

- we support the confirmation, in paragraph 2.10, that the FCA will not apply standards retrospectively with the benefit of hindsight. While we have seen very few examples of retrospective application of standards, it would be an unfair practice in principle, and so it is welcome that the FCA has given this assurance for the future

- we also welcome the provision in DEPP 6.2.9-A that a senior manager will not be bound by a finding of the RDC, a court or a tribunal, to which he or she was not party or privy – clearly, it would be unjust if an individual or individuals were bound by a finding against a firm when they had no right and opportunity to make full and formal representations on their own behalf

- we acknowledge the point made in paragraphs 2.11 – 12 of the CP that the FCA, in considering the application of the duty, might need to look further than a statement of responsibilities and a responsibilities map – this is a point that the regulators have made before and we appreciate that they

would need to consider the precise circumstances of each case, including where a senior manager clearly stepped outside his or her remit *in practice*

- we also acknowledge the other confirmations and clarifications in chapter 2. We note the reasons that the FCA gives regarding why the guidance does not refer to the individuals' management of competing priorities, although this could conceivably be at odds with a regulator looking beyond individual statements of responsibility (see above). We also note that the PRA proposal regarding competing priorities is slightly different (see draft revised SS28/15 paragraph 2.76, bullet no 7). In any case, it would, of course, be open to an individual to plead the point if they considered it material to reasonable steps – much would have to depend on the individual circumstances of the case of course.

CP 16/26 contains only one question, which we now consider and respond to.

Question and BSA response

Q1: Does the draft guidance in Appendix 1 provide clarity on the FCA's proposed application of the duty of responsibility?

8. Turning to Appendix 1, proposed DEPP 6.2.9-A sets out the relevant statutory provision, by way of background. DEPP 6.2.9-B then cross-refers to the existing provisions in 6.2.1G and 6.2.6G. The former states that the FCA will consider the full circumstances of the case in determining whether or not to take action. At this level, because the provisions relate to the question of whether or not to take action for a financial penalty of public censure generally, they are broadly consistent whether they relate to the conduct rules, to being 'knowingly concerned' in a regulatory breach, or breach of the duty of responsibility.

9. DEPP 6.2.1G then sets out a non-exhaustive list of factors that might be relevant, relating to the nature, seriousness and impact of the suspected breach; the conduct of the individual after the breach; his or her previous record and compliance history; and action that the FSA or FCA took in previous similar cases. DEPP 6.2.6G refers to certain other factors relating to the individual's position and responsibilities; whether the most appropriate response is to sanction the individual, the firm or both; and whether disciplinary action would be a proportionate response.

10. There are then a number of proposed new provisions in the remainder of DEPP 6.2.9 providing non-exhaustive guidance on reasonable steps, specifically in relation to an action under section 66(A) of the FSMA – ie the duty of responsibility. Of course, we appreciate that it is not possible for the respective regulatory guidance materials to align exactly because, for instance, the DEPP guidance on reasonable steps relates to the broad issue of contravention of a regulatory requirement, while the conduct rules guidance relates to rather more specific failings in respect of control, compliance, delegation etc. However, it would have been helpful if the regulators could have prepared a combined list of expectations/guidance on the duty of responsibility and reasonable steps. In the absence of such a document, the BSA has carried out the exercise and provided it to our members.

11. Nevertheless, the DEPP guidance contains some sensible and helpful cross-references to the expectations underpinning the conduct rules, regarding NEDs (6.2.9-E G(1)), delegation (6.2.9-E G(8)), control (6.2.9-E G(9)-(10)) etc. DEPP 6.2.9C-D confirms that the regulator will consider the full circumstances of the individual case, and the individual's function and what could reasonably be expected of someone in that role. This is broadly consistent with equivalent guidance relating to the conduct rules; ie COCON 3.1.2-3 and PRA supervisory statement SS28/15 (updated to September 2016).

12. As noted above, a factor set out in DEPP 6.2.1G (5) is *"Action taken by the FSA or FCA in previous similar cases"*. While there are circumstances where it would be perfectly appropriate to consider this factor (see below for example), it needs to be set against the fact that the FSA was a weak enforcer [3] and, as noted above, while the FCA has enforced the rules much more strongly, it was often not possible to sanction individuals (especially in the largest firms) because of lack individual accountability in their governance arrangements. Therefore, in some cases, prior regulatory performance will not be an appropriate or logical measure.

13. Where suspected behaviour could, if ultimately proved by the regulator, constitute a breach of more than one requirement (such as breach of the duty of responsibility, being 'knowingly concerned' in a regulatory breach, and/or breach of one or more of the conduct rules), the regulator would need to be scrupulously consistent in its application of the relevant guidance. We naturally appreciate that each individual case will be different, but a careful and consistent weighing of the various factors should always take place.

14. This would also be an appropriate application of DEPP 6.2.G (5) – so, for example, if a regulator sanctioned a senior manager in a small firm for certain specific misconduct, it should - in a subsequent case - be ready to sanction a senior manager in a very large firm where the facts of the case and the relevant behaviour were substantially the same or where the misconduct was correspondingly serious. We understand why this may not have happened in the past (ie opacity on corporate governance and responsibilities in certain very large firms), but there is absolutely no reason for it not to happen regarding conduct post-Spring 2016.

FOOTNOTES

1 – The total conduct-related fines for 2013-2015 were approximately £2.85billion of which approximately 2.55billion were levied against 10 firms - FCA data

2 - Andrew Bailey, FCA chief executive, 20 July 2016

3 – For example, during 2007, just before the financial crash and when some of the most serious conduct failings were underway, the total fines levied by the FSA was £5.3million – in contrast, FCA fines for 2014 were nearly £1.5billion.

By Chris Lawrenson
Head of Legal Services
chris.lawrenson@bsa.org.uk
020 7520 5915

York House
23 Kingsway
London WC2B 6LU

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

BSA EU Transparancy Register No: 9: 24933110421-64

www.bsa.org.uk

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