

# *Strengthening accountability in banking*

BSA response to FCA DP 16/4:  
Legal function

3 January 2017

 **Building Societies  
Association**

# Introduction

This paper responds to FCA Discussion Paper 16/14 (the DP). The BSA appreciates the fair and open way in which the FCA has discussed the competing arguments behind the possibility of specifically allocating overall responsibility for the management of the legal function to a senior manager.

For the reasons discussed in our response below, we do not support that course of action and take the view that the FCA should maintain the current arrangements. While there are a number of relevant arguments, serious concerns about conflicts of interest in relation to legal professional privilege are at the heart of our position against the suggestion.

The BSA recognises that there are legitimate arguments both ways on this matter. Nevertheless, for the reasons set out below, we believe that – on balance – the strength of the arguments come down in favour of retaining the *status quo*. The clinching point for us is that it would be inappropriate to risk the foreseen (and potentially unforeseen) consequences of a regulatory change that could jeopardise a centuries old fundamental principle of law.

Accordingly, we believe that the FCA should not include a requirement specifically to allocate overall responsibility for the management of the legal function to a Senior Manager.

## Questions and BSA response

**Q1: Do you agree with our summary in Chapter 3 of the key policy arguments for and against inclusion of the management of the legal function in the SMR? Have we missed any key arguments?**

In chapter 3 of the DP, the FCA set out the respective arguments for and against the proposal in a very fair and open manner.

Our comments on the arguments specified in chapter 3 are as follows –

<b>Reasons to exclude the head of legal function from the SMR</b>	
<p>1. <i>The legal function is not an ‘activity, business area or management function’</i></p> <p>2. <i>The legal function is an advisory function</i></p>	<p>For a number of reasons discussed in the paper, part of the legal function (ie legal advice) is not, in our view, an ‘<i>activity, business area, or management function</i>’ within the meaning of the SYSC module.</p> <p>Other aspects of the function (eg identifying laws and regulations that the firm must comply with - and assessing consequent legal risk, managing other lawyers and staff within the department, training, delegation, relevant control etc) are business areas/management functions.</p> <p>It is no doubt this dual aspect of the role that is at the heart of the difficulty underlying the subject matter of the DP.</p>
<p>3. <i>Flexibility to allocate ‘overall responsibility’</i></p>	<p>Although this probably applies to none, or at most very few, of our members, we sympathise with the point, which is again basic to the difficulty underlying the DP’s discussion.</p>
<p>4. <i>Legal professional privilege</i></p>	<p><b>This is the key problem.</b> The principle of legal professional privilege is of very long-standing in English law, going back to the 16<sup>th</sup> Century. The concept has been subject to much discussion and litigation over many years, and the degree of clarity that now exists has been hard won (see eg the <i>Three Rivers</i> litigation <a href="#">here</a>). It is a fundamental principle because, without it, clients might be less inclined to provide full information to their legal advisers and this would, in turn, have significant detrimental effects on the legal system.</p> <p>Although the FCA has responsibility for financial services only, the principle applies throughout the legal system. There are risks and unforeseen consequences in making changes that could affect the principle in the context of one business sector only.</p> <p>While the fact that a fundamental principle is of long-standing does not make it sacrosanct, it does mean that we should tread very carefully before we amend it or take steps that might have the unintended consequence of prejudicing it.</p> <p>We agree that, especially in the context of allegations of breach of the duty of responsibility or being knowingly concerned in a regulatory breach, an individual’s opportunity to establish that they took ‘reasonable steps’ could significantly be impeded if that individual was general counsel SMF and had to rely on the advice that they provided to the firm.</p>

	<p>As noted in the DP, an additional difficulty would be that it would be the firm's decision, not the individual's, whether or not to waive privilege. We consider that this situation could create a serious and potentially irreconcilable conflict of interest between a general counsel SMF and his/her employer. The likelihood of such conflicts arising is fundamental to some of our members' concerns in relation to the potential inclusion of the management of the legal function in the SMR.</p> <p>We also agree that Rule 4 of the Senior Manager Conduct rules is more likely to involve pro-active disclosures than the similar individual conduct rule. Again this could create a tension against legal privilege and a lawyer's duty of confidentiality. Currently, most lawyers will be certificated and, as noted, the individual conduct rule applicable to them provides much less scope for this kind of conflict.</p>
<p><b>5. Independence of the legal function</b></p>	<p>We agree with all the points that the FCA makes on this matter, which would be a natural consequence of a measure constraining or undermining legal advice privilege (see above). Indeed, it could be argued that a general counsel who was also part of the SMF would be advising himself or herself. There is potentially a fundamental and unmanageable conflict.</p>
<p><b>6. Overlap with other regulations</b></p>	<p>While we think it likely that conflicts between the requirements of the financial regulators and the legal regulatory bodies would at most be rare, the possibility could arise in practice. Perhaps more important though, we agree with the Law Society of England &amp; Wales, which has stated that it would increase the regulatory burden on in-house lawyers.</p>
<p><b>7. Insufficient benefits</b></p>	<p>We agree that the application of the certification regime and the individual conduct rules to in-house counsel provides most of the relevant benefits (indeed, in our view, all of the key ones) of including them in the SMR, with fewer of the problems. There are potentially fewer problems because the chance of conflict with legal advice privilege is much less regarding certification and the individual conduct rules, than in respect of the senior manager conduct rules, the duty of responsibility etc.</p> <p>Indeed, where general counsel reports to a SMF holder, such as the chief executive, head of compliance or head of risk, that SMF holder carries the relevant senior manager responsibilities – therefore, there is no responsibilities 'gap'.</p>
<p><b>8. Additional issues</b></p>	<p>We agree with what is stated here. In addition, a lawyer will already have to pass the relevant examinations, go through lengthy training or pupillage, and be admitted by their legal regulatory/professional body. Requiring general counsel to be part of the SMF regime would require the individual to go through further regulatory processes that, to some extent, would duplicate what is there already.</p>

**Reasons to keep the head of the legal function in the SMR**

<p><b>9. <i>The legal function is an activity, business area or management function</i></b></p>	<p>Please see our response to 1 above, which covers this point.</p>
<p><b>10. <i>Failings in the legal function can impact on the wider business</i></b></p>	<p>We do not dispute the point that is made here, but consider that the matter is already covered off (see our response to 7 above).</p>
<p><b>11. <i>Operational management of the function</i></b></p>	<p>Again, we do not dispute paragraph 3.25, but believe that the relevant matters are already covered (see above).</p> <p>We do not agree with paragraph 3.25 insofar as it concerns lawyers – we believe that legal advice and the evidencing of ‘reasonable steps’ are likely to come into conflict where the individual concerned is a lawyer.</p>
<p><b>12. <i>Privilege and the duty of responsibility</i></b></p>	<p>It is possible that the problem would have been more acute had the presumption of responsibility gone ahead. However, in principle, where the onus of proof lies makes little real difference in the context of the DP. Either way, as noted above, legal advice and the evidencing of ‘reasonable steps’ are quite likely to come into conflict where the individual concerned is a lawyer.</p>
<p><b>13. <i>Privilege and independence</i></b></p>	<p>The FCA makes some interesting and thought provoking points here, on which we comment as follows.</p> <p>We acknowledge the protection afforded by section 413 FSMA, but this would not necessarily help a lawyer who needed to evidence reasonable steps by referring to privileged communications.</p> <p>The clarification suggested in paragraph 3.31 of the DP, while potentially helpful to a degree, would not address the point made in the preceding paragraph of this response.</p> <p>Regarding the point made in paragraph 3.32, this is probably true but the individual concerned would not face any initial conflict because (as a non-lawyer) he or she would not be providing the privileged advice in the first place – this is an important point to take into account.</p>
<p><b>14. <i>Flexibility to allocate ‘overall responsibility’</i></b></p>	<p>We agree with what the FCA says in paragraphs 3.33 and 3.34 but they simply reflect the position as it currently stands. We are not clear what they add to the discussion in favour of the proposal.</p>
<p><b>15. <i>No conflict with other regulation</i></b></p>	<p>In 6 above, we acknowledged the point made in paragraph 3.35. We do not think that this is a key point either way (but the additional qualification and</p>

	<p>regulatory burden on lawyers referred to in our comments on 8 above is likely to be heavier than in most other vocations and professions, although we acknowledge that this is not universally true eg actuaries, accountants etc).</p> <p>However, the recent paper commissioned by the Banking Standards Board <a href="#">here</a> underlines in places the retreat since the late 1980s/early 1990s from professional education of bankers in general. There is an imbalance between the training requirements of different functions within financial services firms.</p>
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**Q2: Do you believe that the SM&CR should include a requirement to allocate overall responsibility for the management of the legal function to a Senior Manager? Why?**

The BSA recognises that there are legitimate arguments both ways on this matter. Nevertheless, for the reasons set out above, we believe that – on balance – the strength of the arguments come down in favour of retaining the *status quo*. The clinching point for us is that it would be inappropriate to risk the foreseen (and potentially unforeseen) consequences of a regulatory change that could jeopardise a centuries old fundamental principle of law.

Accordingly, we believe that the FCA should not include a requirement specifically to allocate overall responsibility for the management of the legal function to a Senior Manager.



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 Transparency Register No: 9: 24933110421-64

[www.bsa.org.uk](http://www.bsa.org.uk)

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