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One Year On, Banking Accountability Regime Gears Up

By **Mark Taylor**

Law360, London (March 6, 2017, 10:05 PM GMT) -- Widened conduct rules for British bankers take effect Tuesday, adding more teeth to a regulatory framework that has been a game changer for financial firms since it was first introduced 12 months ago.

The Senior Managers and Certification Regime allows the Financial Conduct Authority to trace responsibility up to the highest levels within banks and other financial institutions when there is evidence of misconduct. In order to comply, firms have had to submit detailed maps outlining who is in charge, as well as statements explaining each senior manager's responsibilities.

"The consistent message from firms is that the SMCR has significantly raised awareness of compliance amongst business areas of firms and, in many cases, changed behavior — although in many cases this has simply meant improving record keeping," said Guy Wilkes, a financial services regulatory and enforcement partner at Mayer Brown LLP.

Lawyers say the new additions to the Senior Managers and Certification Regime around referencing will make it harder for senior staff to conceal blemishes on their records by flitting between firms to evade sanctions. Firms must now also assess "material risk takers" inside regulated businesses, ensuring "fit and proper person" tests are carried out.

"Given that a poor regulatory reference is likely to be career-limiting, we anticipate that this obligation will make settlement of employment disputes more difficult and give rise to some interesting litigation," Wilkes said.

Tuesday's introduction of criteria to ensure certain employees are suited to do their jobs is familiar ground in banking circles, according to Charlotte Hill, a financial regulatory partner at Covington & Burling LLP — but firms cannot afford to pay lip service to the new demands.

"What is new is the evidence that relevant firms have to collect as part of their process for ensuring that candidates are 'fit and proper' and meet the required standards," Hill said.

Firms will now have to provide regulatory references to new employers covering the past six years of employment.

"This will mean that firms will have to be ready to provide regulatory references for employees long departed, thus increasing the need for good records to be kept," she said.

The regime's entry into force last year was a significant milestone in the overhaul of financial regulation stemming from the 2008 financial crisis and white collar crime scandals including efforts to rig the London Interbank Offered Rate, a key interest rate benchmark.

"The introduction of the SMCR was quite significant, and for banks it involved a confluence of senior management and other senior individuals right across the board, from IT to HR — it was unprecedented in that sense," said Imogen Garner, a financial services partner at Norton Rose Fulbright. "There was also a huge amount of work firms had to do in educating people who were senior managers to make sure they knew what was involved. The education has been a major aspect of the change."

But lawyers say plans had long been in the works as part of a wider push to change the culture of London's finance sector and put more accountability on individuals.

"It is a big change from the time of the financial crisis of 2008," Hill said. "But one that has been coming in gradually over time, so no one could pretend to be surprised by it."

It took just six months from the initial start date for the FCA to come up with a bolstered package of demands, teeing the industry up for even greater changes to how businesses operate.

It wants the rules to cover all nonexecutive directors at banks and insurers instead of just designated senior managers. It is also currently mulling an extension of the rule to cover in-house counsel, a move strongly opposed by the Law Society, the legal industry representative body for solicitors in England and Wales.

"The FCA is still consulting on the exact requirements, but firms should be starting to think about what they will need to be doing now," Hill said. "There is quite a bit of work that needs to be done, with a lot more documentation required, such as the new requirements around responsibility maps."

The application of the conduct rules to more staff has gone somewhat under the radar, yet may end up having the biggest and longest-lasting impact, Wilkes said.

"Potentially, this may have a greater effect than the changes which were applied to senior managers last year," he said. "For the first time, bankers in middle management will be subject to direct regulation."

Such changes make it easier for regulators to take enforcement action against individuals when things go wrong.

"We may therefore see a raft of actions against heads of department, heads of desk and other individuals who in the past might have escaped enforcement," Wilkes said.

Wilkes said the twin regulators responsible for oversight, the FCA and bank watchdog the Prudential Regulation Authority, were happy with progress so far, but increasing the dragnet could prove a double-edged sword.

"Whilst it is still early days, paradoxically, the SMCR may make it more difficult for Financial Conduct Authority enforcement to obtain outcomes against senior managers for the simple reason that standards have been raised," Wilkes said.

There have been no prosecutions under the SMCR so far, but legal experts expect that to change as FCA investigators pursue leads against a range of targets expanded to include traders, investment managers and perhaps in-house counsel.

Given the fanfare that accompanied the launch of the SMCR, lawyers say the FCA will also be feeling pressure to deliver on its tough talk.

"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," said Elly Proudlock, counsel in WilmerHale's U.K. investigations and criminal litigation team. "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 is not until a manager facing enforcement action challenges the attribution of responsibility before the Upper Tribunal that the SMCR is likely to be tested in any meaningful way, Proudlock said.

--Additional reporting by Melissa Lipman and William Shaw. Editing by Katherine Rautenberg and Mark Lebetkin.