

Consultation Paper

CP16/26***

Guidance on the duty of responsibility: amendments to the Decision Procedure and Penalties Manual



September 2016

Contents

Abbreviations used in this paper	3
1 Overview	5
2 The duty of responsibility	8
Annex	
1 List of questions	11
Appendix	
1 Draft Handbook text	12

We are asking for comments on this Consultation Paper by 9 January 2017.

You can send them to us using the form on our website at:
www.fca.org.uk/cp16-26-response-form.

Or in writing to:

Harry Caldecott
Enforcement and Market Oversight Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 2966
Email: cp16-26@fca.org.uk

We have developed the policy in this consultation paper in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 0790 or email publications_graphics@fca.org.uk or write to Editorial and Digital Department, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS

Abbreviations used in this paper

The Banking Reform Act	Financial Services (Banking Reform) Act 2013
DEPP	Decision Procedure and Penalties Manual
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
PCBS	Parliamentary Commission on Banking Standards
PRA	Prudential Regulation Authority
Senior Manager	A person approved to perform a senior management function
SMR	Senior Managers Regime

1. Overview

Introduction

- 1.1** In this paper we set out our proposed amendments to the Decision Procedure and Penalties Manual (DEPP) that will give guidance on how we will enforce the 'duty of responsibility'.

Who does this consultation affect?

- 1.2** This consultation will be of interest to UK banks, building societies, credit unions, PRA-designated investment firms, and incoming branches of overseas firms (collectively referred to in this paper as 'relevant firms'), and their Senior Managers.

Is this of interest to consumers?

- 1.3** This paper will mainly be of interest to relevant firms. However, consumers may be interested in how our approach sits within our and the PRA's broader initiative to improve culture and governance in firms.

Context

The SMR, the Certification Regime and the Conduct Rules

- 1.4** Following recommendations by the Parliamentary Commission on Banking Standards (PCBS) in its final report on professional standards and culture in the UK banking sector, Parliament passed the Banking Reform Act. It introduced, amongst other things, the Senior Managers Regime (SMR), the Certification Regime, and the Conduct Rules, and a criminal offence relating to a decision causing a financial institution to fail. These provisions came into force on 7 March 2016.

- 1.5** On 4 May 2016, Parliament passed the Bank of England and Financial Services Act 2016, which introduced the 'duty of responsibility'. The duty of responsibility came into force on 10 May.

The SMR

- 1.6** The SMR applies to individuals performing a senior management function (Senior Managers), specified by either us or the PRA on behalf of relevant firms.
- 1.7** When applying for regulatory pre-approval for an individual to perform a senior management function, a relevant firm is required to submit a Statement of Responsibilities to the regulators.

This must set out the areas of the firm that the prospective Senior Manager will be responsible for managing. The firm must resubmit the Statement of Responsibilities whenever there is a significant change in the Senior Manager's responsibilities. Relevant firms must also prepare a management responsibilities map, setting out their governance and management arrangements, and how responsibilities are allocated to individuals within the firm. When bringing enforcement action against a Senior Manager – whether under the Conduct Rules, the duty of responsibility or otherwise – the FCA will consider the Statement of Responsibilities and the firm's management responsibilities map when determining the extent of the Senior Manager's responsibilities in the firm.

The duty of responsibility

1.8 Under the duty of responsibility, we and the PRA can take action against Senior Managers if they are responsible for the management of any activities in their firm in relation to which their firm contravenes a regulatory requirement, and they do not take such steps as a person in their position could reasonably be expected to take to avoid the contravention occurring (or continuing). The duty will apply across the financial services industry when the SMR is extended.¹

1.9 The duty of responsibility requires the regulators to prove a contravention of a regulatory requirement by the firm, and that the Senior Manager was responsible for the management of any activities in their firm in relation to which the firm's contravention occurred. The burden of proof lies with the regulators to show that the Senior Manager did not take such steps as a person in their position could reasonably be expected to take to avoid the firm's contravention occurring.

Conduct Rules

1.10 The duty of responsibility is supported by Conduct Rules. The Conduct Rules set basic standards of good conduct for staff. We may take disciplinary action against individuals whose conduct falls short of these standards. A subset of the Conduct Rules only applies to Senior Managers. These include that reasonable steps are taken to ensure the business of the firm is controlled effectively, that the business complies with regulatory requirements and that any delegation of responsibilities is appropriate and properly overseen. We may take disciplinary action against a Senior Manager for breaching the Conduct Rules, being knowingly concerned in a firm's contravention of a regulatory requirement, or for breaching the duty of responsibility, or a combination.

Summary of our proposals

1.11 We previously consulted on guidance in CP14/13² and CP15/9³ on how we would enforce the presumption of responsibility, which the duty of responsibility has since replaced. We are now consulting on guidance on how we will enforce the duty of responsibility. Our guidance includes a non-exhaustive list of considerations that we will keep in mind when determining whether or not a Senior Manager took such steps as a person in their position could reasonably be expected to take to avoid the firm contravention occurring (or continuing).

¹ *Senior Managers and Certification Regime: extension to all FSMA authorised persons*, Treasury white paper, October 2015

² FCA CP14/13 and PRA CP14/14 *Strengthening accountability in banking: a new regulatory framework for individuals* (July 2014)

³ CP15/9 *Strengthening accountability in banking: a new regulatory framework for individuals* (March 2015)

Equality and diversity considerations

- 1.12** We have assessed the likely equality and diversity impacts of the proposals and do not think they give rise to any concerns. But we would welcome your comments.

Cost benefit analysis

- 1.13** We have not conducted a cost benefit analysis, as our guidance does not impose any material additional costs on firms beyond those costs intended by the legislation under which the duty of responsibility was introduced.

What do you need to do next?

- 1.14** We want to know what you think of our proposals. Please send us your comments by **9 January 2017**.

How?

- 1.15** Use the online response form on our website or write to us at the address on page 2.

What will we do?

- 1.16** We will consider your feedback and publish a Policy Statement early next year, setting out guidance on how we will enforce the duty of responsibility.

2. The duty of responsibility

Introduction to the duty of responsibility

- 2.1** The duty of responsibility applies to Senior Managers at Relevant Authorised Persons (in this chapter, referred to as the 'firm').
- 2.2** Under the duty of responsibility, the FCA is able to take action against a Senior Manager where:
- there has been (or continued to be) a contravention of a relevant requirement by the Senior Manager's firm
 - at the time of the contravention, 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 such steps as a person in their position could reasonably be expected to take to avoid the contravention occurring (or continuing)

Guidance

- 2.3** We are consulting on guidance which sets out:
- the circumstances in which we will apply the duty
 - a non-exhaustive list of considerations that may be relevant when determining whether a Senior Manager was responsible for the management of any of a firm's activities in relation to which a contravention of a relevant requirement by the firm occurred
 - a non-exhaustive list of considerations we will keep in mind when determining whether or not a Senior Manager took such steps as a person in their position could reasonably be expected to take to avoid the firm contravention occurring (or continuing)
- 2.4** The guidance is not prescriptive about the steps that a Senior Manager should take to avoid a firm contravention occurring, as the steps reasonably expected of a Senior Manager will vary from case to case, depending on the circumstances. For this reason, it does not set out examples of the steps reasonably expected of Senior Managers at specific types of firms, such as credit unions or large banks.
- 2.5** We have worked closely with the PRA to ensure that our guidance on the duty of responsibility is consistent and aligned with theirs.

2.6 Senior Managers should be aware that one important consideration to which the FCA would expect to have regard, when determining whether or not a Senior Manager has complied with the duty, is whether the Senior Manager acted in accordance with their statutory, common law and other legal obligations, including, but not limited to, the Conduct Rules (and other relevant rules) set out in the FCA Handbook. There is considerable guidance on the reasonable steps a Senior Manager must take in the Conduct Rules. Senior Managers might find it helpful to have regard to the guidance on the duty when considering how to comply with the Conduct Rules.

2.7 In producing this guidance, we have sought to address relevant responses to our consultations on guidance we proposed for the presumption of responsibility. We summarise our position on those responses by subject matter below.

The effect of findings against a firm on a separate action brought against a Senior Manager under the duty of responsibility

2.8 Our guidance at DEPP 6.2.9–A G states that in an action brought by the FCA against a Senior Manager under the duty of responsibility, the Senior Manager is not bound by a finding of the RDC, a court or a tribunal, which he or she was not privy nor party to.

No materiality threshold for enforcement action under the duty of responsibility

2.9 We will decide whether to take action based on the duty of responsibility by applying our published criteria in DEPP. We will look at all the circumstances of the case, including the seriousness of the breach; the relevant individual’s position, responsibilities and seniority; and the need to use enforcement powers effectively and proportionately. We do not believe that there is a need for any additional threshold.

Whether the FCA will apply standards retrospectively

2.10 We will not apply standards retrospectively or with the benefit of hindsight. This is reflected in our guidance at DEPP 6.2.9-D G. Our guidance states that when we apply the duty of responsibility, we will consider what steps a competent Senior Manager would have taken at that time in that specific individual’s position with that individual’s role and responsibilities in all the circumstances.

The extent of a Senior Manager’s responsibilities – DEPP 6.2.9-C G

2.11 It is possible for Senior Managers to be responsible for the management of activities at their firm that fall outside their prescribed responsibilities. So we have not stated in our guidance that the duty of responsibility will only apply in relation to a Senior Manager’s responsibilities set out in the Statement of Responsibilities. Such guidance could fetter our ability to rely on the duty in a way not specified by Parliament.

2.12 Whether a Senior Manager is responsible for the management of any of a firm’s activities will be a question of fact. We may not be able to check that statement of responsibilities and management responsibilities maps fully and accurately describe the activities a Senior Manager is responsible for managing without looking behind them. Statements of responsibilities and management responsibilities maps will therefore be relevant considerations, but there will be other relevant considerations too.

The relevance of the considerations to all Senior Managers – DEPP 6.2.9-E G

2.13 All the considerations in DEPP 6.2.9-E G are potentially relevant to an assessment of the steps reasonably expected of all Senior Managers, whatever their role and responsibilities. For this reason, we do not distinguish in our guidance between considerations that may only be relevant to Senior Managers performing an executive role, and considerations that may only be relevant to Senior Managers who are non-executive directors. What is reasonable in relation to each consideration will depend on the specific individual’s position, role and responsibilities and all

the circumstances. Our guidance does, however, make allowance for the fact that the steps a Senior Manager in a non-executive role could reasonably be expected to take may differ, depending on the circumstances, from those reasonably expected of a Senior Manager in an executive role.

Collective decision-making – DEPP 6.2.9-E G (15)

- 2.14** Under the duty of responsibility, Senior Managers are accountable for their individual contributions to collective decisions and their implementation insofar as they concern any of the firm’s activities for which they are responsible.

Competing priorities

- 2.15** We have decided that we will not state in our guidance that we would expect to have regard to whether a Senior Manager has taken reasonable steps to manage competing priorities, when determining whether or not a Senior Manager had taken such steps as a person in their position could reasonably be expected to take to avoid the firm’s contravention occurring. We do not believe that it would be helpful, as it does not clarify the steps reasonably expected of Senior Managers when doing so. We also want 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 deprioritise concerns about conduct.
- 2.16** Our guidance states that when determining whether or not a Senior Manager took such steps as a person in their position could reasonably be expected to take to avoid the firm’s contravention, we must consider all the circumstances. It also states that we would expect to have regard to whether a Senior Manager delegated appropriately, and to the nature, scale and complexity of the firm’s business.

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

Annex 1

List of questions

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

Appendix 1

Draft Handbook text

**INDIVIDUAL ACCOUNTABILITY (ENFORCEMENT) (DUTY OF
RESPONSIBILITY) INSTRUMENT 2016**

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 69 (Statement of policy);
 - (2) section 139A (Power of the FCA to give guidance); and
 - (3) section 210(1) (Statements of policy).

Commencement

- B. This instrument comes into force on [*date* 2016].

Amendments to the Handbook

- C. The Decision Procedure and Penalties manual (DEPP) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Individual Accountability (Enforcement) (Duty of Responsibility) Instrument 2016.

By order of the Board
[*date* 2016]

Annex

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

6.2 Deciding whether to take action

...

Action against individuals under section 66 of the Act

...

6.2.6A G DEPP 6.2.6BG to DEPP 6.2.9G apply to action taken by the FCA under section 66 of the Act, except for action taken by virtue of section 66A(5). DEPP 6.2.9-AG to DEPP 6.2.9-FG apply only to action taken by virtue of section 66A(5).

...

6.2.9 G ...

Action against an SMF manager under section 66A(5) of the Act

6.2.9-A G The FCA is able to take action against an SMF manager under section 66A(5) of the Act where:

- (1) there has been (or continued to be) a contravention of a relevant requirement by the SMF manager's firm;
- (2) at the time of the contravention, the SMF manager was responsible for the management of any of the firm's activities in relation to which the contravention occurred; and
- (3) the SMF manager did not take such steps as a person in their position could reasonably be expected to take to avoid the contravention by the firm occurring (or continuing).

In such an action, an SMF manager is not bound by a finding of the RDC, a court or a tribunal, which he or she was not privy nor party to.

6.2.9-B G When deciding whether to take action further to section 66A(5) of the Act, the FCA will follow the approach in DEPP 6.2.1G and DEPP 6.2.6G.

6.2.9-C G When determining, for the purposes of section 66A(5) of the Act, whether an SMF manager was responsible for the management of any of the firm's activities in relation to which a contravention of a relevant requirement by the firm occurred, the FCA will consider the full circumstances of each case. A list of considerations that may be relevant for this purpose is set out

below. This list is not exhaustive.

- (1) The *SMF manager's* statement of responsibilities, including whether the *SMF manager* was performing an executive or non-executive role.
- (2) The *firm's* management responsibilities map.
- (3) How the *firm* operated, and how responsibilities were allocated in the *firm* in practice.
- (4) The *SMF manager's* actual role and responsibilities in the *firm*, to be determined by reference to, among other things, minutes of meetings, emails, regulatory interviews, telephone recordings and organisational charts.
- (5) The relationship between the *SMF manager's* responsibilities and the responsibilities of other *SMF managers* in the *firm* (including any joint responsibilities or matrix management structures).

6.2.9-D G Under section 66A(5)(d) of the *Act*, such steps as a person in the position of the *SMF manager* could reasonably be expected to take to avoid the *firm's* contravention of a relevant requirement occurring (or continuing) are:

- (1) such steps as a competent *SMF manager* would have taken:
 - (a) at that time;
 - (b) in that specific individual's position;
 - (c) with that individual's role and responsibilities; and
 - (d) in all the circumstances.

6.2.9-E G When determining under section 66A(5)(d) of the *Act* whether or not an *SMF manager* has taken such steps as a person in their position could reasonably be expected to take to avoid the contravention of a relevant requirement by the *firm* occurring (or continuing), additional considerations to which the *FCA* would expect to have regard are, but are not limited to:

- (1) the role and responsibilities of the *SMF manager* (for example, such steps as an *SMF manager* in a non-executive role could reasonably be expected to take may differ, depending on the circumstances, from those reasonably expected of an *SMF manager* in an executive role; see, for example, the guidance on the role and responsibilities of *non-executive directors for relevant authorised persons* in *COCON 1 Annex 1*);
- (2) whether the *SMF manager* exercised reasonable care when considering the information available to them;
- (3) whether the *SMF manager* reached a reasonable conclusion on which to act;

- (4) the nature, scale and complexity of the *firm*'s business;
- (5) the knowledge the *SMF manager* had, or should have had, of regulatory concerns, if any, relating to their role and responsibilities;
- (6) whether the *SMF manager* (where they were aware of, or should have been aware of, actual or suspected issues that involved possible breaches by their *firm* of relevant requirements relating to their role and responsibilities) took reasonable steps to ensure that the issues were dealt with in a timely and appropriate manner;
- (7) whether the *SMF manager* acted in accordance with their statutory, common law and other legal obligations, including, but not limited to, those set out in the Companies Act 2006, the *Handbook* (including *COCON*), and, if the *firm* was listed on the London Stock Exchange, the *UK Corporate Governance Code* and related guidance;
- (8) whether the *SMF manager* took reasonable steps to ensure that any delegation of their responsibilities, where this was itself reasonable, was to an appropriate person with the necessary capacity, competence, knowledge, seniority and skill, and whether the *SMF manager* took reasonable steps to oversee the discharge of the delegated responsibility effectively;
- (9) whether the *SMF manager* took reasonable steps to ensure that the reporting lines, whether in the *UK* or *overseas*, in relation to the *firm*'s activities for which they were responsible, were clear to staff and operated effectively;
- (10) whether the *SMF manager* took reasonable steps to satisfy themselves, on reasonable grounds, that, for the activities for which they were responsible, the *firm* had appropriate policies and procedures for reviewing the competence, knowledge, skills and performance of each individual member of staff to assess their suitability to fulfil their duties;
- (11) whether the *SMF manager* took reasonable steps (including in relation to SYSC 4.9) to assess, on taking up each of their responsibilities, and monitor, where reasonable, the governance, operational and risk management arrangements in place for the *firm*'s activities for which they were responsible (including, where appropriate, corroborating, challenging and considering the wider implications of the information available to them), and whether they took reasonable steps to deal with any actual or suspected issues identified as a result in a timely and appropriate manner;
- (12) whether the *SMF manager* took reasonable steps to ensure an orderly transition when another *SMF manager* under their oversight or responsibility was replaced in the performance of that function by someone else;

- (13) whether the *SMF manager* took reasonable steps to ensure an orderly transition when they were replaced in the performance of their function by someone else;
- (14) whether the *SMF manager* failed to take reasonable steps to understand and inform themselves about the *firm's* activities for which they were responsible, including, but not limited to, whether they:
- (a) failed to ensure adequate reporting or seek an adequate explanation of issues within a business area, whether from people within that business area, or elsewhere within or outside the firm, if they were not an expert in that area; or
 - (b) failed to maintain an appropriate level of understanding about an issue or a responsibility that they delegated to an individual or individuals; or
 - (c) failed to obtain independent, expert opinion where appropriate from within or outside the *firm* as appropriate; or
 - (d) permitted the expansion or restructuring of the business without reasonably assessing the potential risks; or
 - (e) inadequately monitored highly profitable *transactions*, business practices, unusual *transactions*, or individuals who contributed significantly to the profitability of a business area or who had significant influence over the operation of a business area;
- (15) whether the *SMF manager* took reasonable steps to ensure that, where they were involved in a collective decision affecting the *firm's* activities for which they were responsible, and it was reasonable for the decision to be taken collectively, they informed themselves of the relevant matters before taking part in the decision, and exercised reasonable care, skill and diligence in contributing to it;
- (16) whether the *SMF manager* took reasonable steps to follow the *firm's* procedures, where this was itself appropriate;
- (17) how long the *SMF manager* had been in role with their responsibilities and whether there was an orderly transition and handover when they took up the role and responsibilities;
- (18) whether the *SMF manager* took reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems and controls to comply with the relevant requirements and standards of the regulatory system for the activities of the *firm*.

6.2.9-F G Where action is taken against an *SMF manager* under section 66A(5) of the *Act* the onus will be on the *FCA* to show that the *SMF manager* has been

guilty of misconduct.

Action under section 63A of the Act against persons that perform a controlled function without approval

Financial Conduct Authority



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25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
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