

Branching out: UK government sets out plans to extend scope of individual accountability regimes

HM Treasury has published a draft statutory instrument to bring UK branches of overseas banks within the scope of the Senior Managers and Certification regimes and conduct rules due to come into force in 2015.

The proposed order and accompanying short consultation paper builds on the lengthy and detailed consultation paper and draft rules and guidance on individual accountability published jointly by the FCA and PRA in July 2014.

For full details of the proposals in relation to UK banks, which are set out in the Financial Services (Banking Reform) Act 2013 ("FSBRA") and which emanate from the recommendations of the Parliamentary Commission on Banking Standards, see our [previous briefing](#).

The story so far

As currently drafted, the provisions of FSBRA apply only to "Relevant Authorised Persons", which translates as UK based banks, building societies and credit unions operating deposit taking businesses and certain UK based investment banks.

The UK government made clear its intention to extend the scope of the individual accountability regimes to UK branches of overseas banks even before the FCA and PRA had issued their detailed proposals on the application of the regimes to UK based institutions. In June 2014, the Chancellor of the Exchequer foreshadowed HM Treasury's consultation paper in his Mansion House speech and letters to the Governor of the Bank of England and the Chairman of the FCA.

The proposals elicited immediate positive commitments from both the FCA and PRA to bring UK branches of overseas banks within the perimeter of the new individual accountability regimes. However, only one of the 395 pages of their July 2014 joint consultation paper is devoted to how they intend to apply the regimes to UK branches of overseas institutions. No timescales have yet been given by the FCA or the PRA in relation to more detailed

consultation exercises. Technical consultation papers are likely to be published in the coming months. The issue of branches may be subsumed into this technical consultation, but given the complexity of the subject matter a later stand-alone consultation is more likely.

How will the Senior Managers Regime apply to UK branches of overseas banks?

Neither the PRA nor the FCA have at this stage given any detailed indications in relation to their proposed approaches towards senior executives in UK branches of overseas institutions. Placeholders have been left in their respective draft rules and guidance. At present though, the position of the PRA is clearer than that of the FCA.

The PRA has indicated that it does not intend to concern itself with the approval of senior managers in UK branches of EEA authorised banks. As far as UK branches of non-EEA authorised banks are concerned, consistent with that set out in its separate consultation paper on the supervision of international banks (which has since solidified into a policy statement and separate supervisory statement), it has proposed a relatively permissive approach to the application of the Senior Managers Regime.

It has stated that it proposes to require "at least one" individual per incoming branch to be approved as an "Overseas Branch Senior Executive". This individual or these individuals will be required to take responsibility for the Senior Management Function of "having responsibility alone or jointly with others for the conduct of all activities" of the UK branch. It has to date not elaborated further, save to say that it may require more than one individual to be approved "in some circumstances" and that it expects that the individual or individuals approved will be those

performing activities akin to those of a CEO in relation to the branch.

Other parts of the July 2014 consultation paper make clear that the PRA will look at the substance of the roles of individuals put forward by firms rather than their specific job title when assessing whether they are the appropriate person to be approved. The statutory objectives laid out for the PRA in the Financial Services and Markets Act 2000 and its approach to other areas of its remit suggest that it will make an assessment of the numbers of individuals required to be approved in respect of each branch by reference to factors including the size, complexity, perceived systemic importance and risk profile of that branch.

The FCA has not to date given any detailed indications of how it intends to approach UK branches (whether of EEA or non-EEA authorised banks), preferring to reserve its position until the detail of the draft instrument now published by HM Treasury has been finalised. However it has indicated that it is considering whether "it is possible to adapt what is currently in the FCA Handbook on Significant-Influence Functions to Senior Managers. The current SIFs cover FCA governing functions, required functions, systems and controls functions and significant management functions," and "In relation to individuals falling within the Certification Regime and the other Conduct Rules staff categories, the FCA will consider whether it is possible to apply a regime that is equivalent in effect to that which it applies to UK banks, insofar as it is consistent with Single Market Directives for EEA branches". Reconciling the responsibilities of EEA home state regulators for approving individuals with the FCA's duties to oversee the day to day conduct of banks carrying on regulated activities in the UK will be particularly difficult. It is likely that, as is currently the case for UK based "Relevant Authorised Persons", the FCA will require a larger population of individuals within UK branches to be approved as senior managers than the PRA.

The regulatory impact assessment accompanying HM Treasury's draft instrument and consultation paper provisionally indicates that, typically, five or six individuals per UK branch will be required to be authorised as senior managers.

The FCA may wish to use its right to consent to any new PRA Overseas Branch Senior Executive as a starting point for its own proposals.

Will the reverse burden of proof apply to senior managers in UK branches of overseas banks?

The joint FCA and PRA consultation paper published in July 2014 and the paper now published by HM Treasury are silent on the point, but the expectation is that, for those individuals in UK branches of overseas institutions falling within the Senior Managers Regime, the reverse burden of proof will apply in the same way as for individuals in UK based "Relevant Authorised Persons".

This means that, in the event that the branch breaches regulatory requirements in their area of responsibility, the onus will be on individual senior managers to establish that they took such steps as they could reasonably be expected to have taken to avoid the contravention occurring (or continuing).

How will the Certification Regime and conduct rules apply to UK branches of overseas banks?

Both the FCA and PRA have given slightly more detail in relation to the application of their respective Certification Regimes to UK branches of overseas banks than they have in respect of the Senior Managers Regime, although again further clarification will follow in more detailed consultation exercises.

The PRA has confirmed that its Certification Regime will not apply to incoming branches of EEA institutions. For incoming branches of non-EEA institutions, it has indicated that it proposes to delineate the boundaries of the regime in essentially the same way as for UK based institutions, by reference to the definition of "material risk taker" for the purposes of the Remuneration Code.

The FCA has at this stage simply stated that it will consider whether it is possible to apply equivalents to the Certification regime and conduct rules to UK branches of overseas banks, but has expressed concerns about potential tensions with the conduct regulation responsibilities of EEA and non-EEA home state regulators.

Again, the detail will emerge in future consultation papers, although current expectations are that populations of individuals subject to the FCA Certification Regime and Conduct Rules in UK branches of overseas institutions will be larger than those subject to the PRA's corresponding regime and rules.

Will the new criminal offence apply to senior managers in UK branches of overseas banks?

No. The proposed order does not extend the scope of the new criminal offence of reckless mismanagement of a bank to senior managers in UK branches of overseas banks, leaving the task of prosecuting those responsible for decisions resulting in the failure of a UK branch to home state regulators (in jurisdictions where the relevant legislation permits them to do so).

What happens next?

HM Treasury has invited responses to its consultation paper by 30 January 2015. The FCA and PRA are expected to publish their more detailed consultation papers on the extension of the regime to UK branches of overseas banks in the subsequent period.

The extension of the regime may be a lengthy process. Whilst it appears to be the regulators' continued aim to issue comprehensive policy statements covering UK based institutions and UK branches of overseas institutions by in mid 2015, it may not be possible for the two sets of proposals to progress concurrently.

Indeed, whether the previously mooted timescales for the implementation of the regimes as they apply to UK based institutions remain realistic is open to question. The regulators must issue policy statements by 30 March 2015, when the purdah period commences in advance of the general election (during which time announcements about sensitive initiatives may not be made), if the regimes are to be implemented during this Parliament.

The time pressures are particularly acute if they wish to seek to build in the extension of the new regimes to UK branches of overseas banks as time will have to be found in a congested parliamentary calendar for the draft order to navigate the affirmative resolution procedure, which requires it to be considered by both houses.

Meanwhile, debate continues about how far the new individual accountability regimes should extend in the longer term. Andrew Tyrie, the Chairman of the

Parliamentary Commission on Banking Standards and lead architect of the proposals leading to the new regimes, continues to call for the existing Approved Persons Regime to be scrapped for firms other than banks. The report published by the Treasury Select Committee last month in connection with its recent inquiry into the failure of Project Verde refers to statements made by Clive Adamson, the FCA's Director of Supervision, in which he appeared to agree with the extension of the new individual accountability regimes across the financial services industry.

Whether that suggestion gains traction remains to be seen, but insurers and asset managers, already grappling with the implementation of substantial and complex changes flowing from developments such as the Solvency II Directive will wish to monitor levels of support for any proposals that the regimes are further extended.

Contacts

Imogen Clark

Partner, Tax,
Pensions and
Employment
+44 20 7006 8203

Dorian Drew

Partner, Litigation and
Dispute Resolution
+44 20 7006 1389

Kelwin Nicholls

Partner, Litigation and
Dispute Resolution
+44 20 7006 4879

Chris Stott

Lawyer, Litigation and
Dispute Resolution
+44 20 7006 4231

Carlos Conceicao

Partner, Litigation and
Dispute Resolution
+44 20 7006 8281

Chris Goodwill

Partner, Tax,
Pensions and
Employment
+44 20 7006 8304

Alistair Woodland

Partner, Tax,
Pensions and
Employment
+44 20 7006 8936

Phillip Souta

Head of UK Public
Policy
+44 20 7006 1097

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www.cliffordchance.com

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