

Conduct Rules Scenarios

Accident Causes Office Disruption

Scenario

You are the Chief Executive Office of Friendly Wealth Management Ltd, a small wealth manager and Core Firm for SM&CR purposes.

Bob Smith, is the firm's COO and SMF16. Bob also holds the Prescribed Responsibilities for implementation of the Senior Managers Regime, the Certification Regime and the Conduct Rules.

Bob was knocked off his motorcycle 4 months ago. He spent 6 weeks in intensive care and only returned home 2 weeks ago. Bob is now convalescing but a full recovery is likely to take some time – Bob is still suffering from quite severe headaches and pain in his back. You do not know when (or if) Bob will be able to return to the office.

Friendly Wealth Management Ltd has historically relied on a third-party firm of compliance consultants for assistance with the SM&CR. Bob has no deputy (this position has been vacant for a while) and has left no handover note. It's not clear 'who does what'. Bob is old-school and it was 'all in his head'. In the past you've tried – and failed – to get him to be a bit more organised.

Covid-19 hit the business hard. For the last 12 months you have been busy trying to generate revenue in order to keep the business afloat as well as dealing with the various organisational challenges that Covid-19 has presented. You are aware that they have been a number of "issues" amongst the staff but you haven't had time to look further into the detail as you scramble to 'steady the ship'.

What conduct rules may have been breached?

- Individual Conduct Rule 2: "You must act with due skill, care and diligence".
- Senior Manager Conduct Rule 1: "You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively".
- Senior Manager Conduct Rule 2: "You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system".
- Senior Manager Conduct Rule 4: "You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice".

Points to consider

General

In order to be considered in-scope for the purposes of the Conduct Rules, the conduct in question must relate to the regulated or unregulated “financial activities” of the firm.

Under COCON 3.1.3G, a person will only be in breach of a Conduct Rule where they are personally culpable. In other words, the person’s conduct must have been:

1. Deliberate, or
2. Below the standard of conduct that would be reasonable in all of the circumstances.

Pursuant to COCON 3.1.2G, in assessing whether a breach of the Conduct Rules has occurred, the FCA will have regard to the context in which a course of conduct was undertaken, including:

1. The precise circumstances of the individual case,
2. The characteristics of the particular function performed by the individual in question, and
3. The behaviour expected of that function.

The FCA will also take into account whether the conduct in question (a) relates to activities that are subject to other provisions of the FCA Handbook, or (b) is consistent with the requirements and standards of the regulatory system (as far as it applies to the firm).

Pursuant to COCON 3.1.5G and 3.1.6G, in determining whether a breach of the Senior Manager Conduct Rules has occurred, the FCA will take into account:

1. Whether the Senior Manager exercised reasonable care when considering the information available to them,
2. Whether the Senior Manager reached a reasonable conclusion upon which to act,
3. The nature, scale and complexity of the firm’s business (the smaller and less complex the business, the less detailed and extensive the systems of control in place need to be – and vice versa),
4. The role and responsibility of the Senior Manager as determined by reference to his/her Statement of Responsibilities, and
5. The knowledge which the Senior Manager had, or should have had, of regulatory concerns (if any) relating to their role and responsibilities.

In terms of the territorial application of the Conduct Rules, in general the Conduct Rules only apply to ‘UK activity’. More specifically, the Conduct Rules apply to:

1. Conduct performed from an establishment maintained in the UK by a firm which is subject to the SM&CR, or

2. Conduct which involves dealing with a UK-based client of a UK firm which is subject to the SM&CR from an establishment overseas.

However, the Conduct Rules apply to the conduct of the following individuals wherever it is performed:

1. A Senior Manager, or
2. An employee of an SM&CR firm who performs the function of a Senior Manager, or
3. A non-executive director, or
4. A Certification Employee who performs Certification Function (6) (“Material Risk Taker”).

Ultimately, the firm will have to notify the FCA of any breach of the Conduct Rules. Normally, breaches of the Conduct Rules by non-Senior Managers must be notified to the FCA annually in October using Form H (also known as “REP008 – Notification of Disciplinary Action”). However, the following types of breaches must be reported to the FCA “immediately”:

1. Any “significant” breach of a Conduct Rule (SUP 15.1.7G(1) and SUP 15.3.11R(1)(a)), or
2. Any matter that could have a significant adverse effect on the firm’s reputation (SUP 15.3.1R(3)), or
3. The occurrence of any fraud with respect to any member of staff (SUP 15.2.17R).

The FCA must be notified of any breach of the Conduct Rules by a Senior Manager within 7 days, pursuant to SUP 10C Annex 2G.

You and Bob

Individual Conduct Rule 2 requires individuals to ‘act with due skill, care and diligence’. The FCA provides specific guidance on what this means in the context of a manager within a firm. The FCA accepts that a manager is unlikely to be an expert in all aspects of a complex financial services firm. However, they should understand and inform themselves about the business sufficiently to understand the risks of its business activities. A failure to do so would be regarded by the FCA as a breach of **Individual Conduct Rule 2**, as would ‘failing to take reasonable steps to ensure that the business of the firm for which the manager has responsibility is controlled effectively, complies with regulatory requirements and ensures effective delegation’. In this sense, there is significant overlap between **Individual Conduct Rule 2** and both **Senior Manager Conduct Rule 1** and **Senior Manager Conduct Rule 2**.

Senior Manager Conduct Rule 1 requires Senior Managers to ‘take reasonable steps to ensure that the business of the firm for which they are responsible is controlled effectively’. **Senior Manager Conduct Rule 2** requires Senior Managers to ‘take reasonable steps to ensure that the business of the firm for which they are responsible complies with the relevant requirements and standards of the regulatory system’.

In terms of complying with **Senior Manager Conduct Rule 1**, the FCA emphasises the importance of clear organisational structure and reporting lines as well as tailored job descriptions. Handover notes are not, strictly speaking, required for Core Firms (such as Friendly Wealth Management Ltd). However, they are generally regarded as a good idea for all firms. They are specifically referred to with the FCA guidance relating to Senior Manager Conduct Rule 1. Admittedly, the reference to handover notes is made in the context of the “orderly transition” from one Senior Manager who is vacating a position to his/her successor. As such, it does not specifically envisage unexpected absences such as Bob Smith’s motorcycle accident. Nonetheless, whether you call it a “handover note” or not, the documentation of the structure of, and issues impacting, a business is a reasonable step for any Senior Manager to take. As such, Bob’s failure to provide any form of handover note or similar documentation would seem to constitute both a breach of **Individual Conduct Rule 2** and **Senior Manager Conduct Rule 1**.

Bob’s breach of **Individual Conduct Rule 2** and **Senior Manager Conduct Rule 1** is compounded by the fact of his failure to appoint a deputy, despite the fact that this has been a known vacancy for some time. As part of compliance with **Senior Manager Conduct Rule 1**, the FCA requires a Senior Manager to pay attention to temporary vacancies (particularly managerial vacancies) and to take reasonable steps to arrange suitable cover so as to ensure continued compliance with regulatory requirements.

The fact that it is not clear to you exactly ‘who does what’ within Bob’s area, suggests that Bob has failed to properly apportion responsibilities to the team. This is another factor that is relevant in determining whether a breach of **Senior Manager Conduct Rule 1** has occurred.

You must also accept responsibility here too. You should have done more to require Bob to organise his department properly and to document all processes and controls. Failing this, you should have considered whether Bob was actually a suitable candidate to be the Senior Manager with responsibility in this area. Your failure to do this is likely to render you in breach of **Senior Manager Conduct Rule 1** as well.

It seems likely that your breaches of **Senior Manager Conduct Rule 1** extend further than merely a failure to ensure Bob complied with the requirements of the SM&CR. You tried to assume responsibility for, and oversight of, Bob’s business area whilst he has been out of the office but the evidence would suggest that you do not have the time to exercise effective control. You missed the opportunity to appoint a temporary replacement for Bob under the ‘emergency 12-week rule’ (although it is not possible to allocate Prescribed Responsibilities to anyone who is not a Senior Manager). Your failure to exercise proper control or to appoint someone who can has left Bob’s business area largely rudderless. The matter is made worse by the fact that there seem to be a number of issues which may be actual, potential or suspected breaches of the Conduct Rules within Bob’s business area. Unfortunately, on the facts, it seems that these potential breaches are not been assessed or reported. This failure to implement or monitor controls is also likely to result in a breach of **Senior Manager Conduct Rule 2** by you.

You should also be aware that ultimate responsibility for any unallocated Prescribed Responsibility (which had previously been allocated to Bob Smith) falls to you as the Chief Executive Officer. On the facts as we have them, you have not done anything to ensure the effective discharge of these responsibilities.

Senior Manager Conduct Rule 4 requires Senior Managers to 'disclose appropriately any information of which the FCA or PRA would reasonably expect notice'. To remain in compliance with the Conduct Rule, you should have notified the FCA of Bob's absence, it's likely timescales and the steps the firm was taking to mitigate the situation. Your failure to do this is likely to render you in breach.