

# Conduct Rules Scenarios

## Backdating Documents

### Scenario

Hilary is a Certification Employee. She is an independent financial advisor working for Trusty Wealth Management Ltd.

Hilary has been working from home due to lockdown. She has been juggling her role as a financial advisor with home schooling. As a result she has fallen behind on her work in general, and her paperwork in particular.

Hilary forgets to make ISA submissions before the April deadline on behalf of a number of clients. Rather than confess to the mistake, she backdates all of her ISA forms to the day before the deadline.

The issue does not become apparent until an external audit, conducted 9 months after the ISA deadline, asks for evidence surrounding the ISA discussions Hilary had with her client. At this point it becomes evident that Hilary could not have submitted the ISA forms ahead of the deadline.

### What conduct rules may have been breached?

- Individual Conduct Rule 1: "You must act with integrity".
- Individual Conduct Rule 2: "You must act with due skill, care and diligence".
- Individual Conduct Rule 4: "You must pay due regard to the interests of customers and treat them fairly".
- Individual Conduct Rule 5: "You must observe proper standards of market conduct".

### 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.

## Hilary

Hilary’s conduct does relate to the regulated or unregulated “financial activities” of Super Broker Ltd. As such, it is in-scope for the purposes of the Conduct Rules. Obviously, Hilary is a Certification Employee, but not a Senior Manager. As such, only the Individual Conduct Rules apply to Hilary, not the Senior Manager Conduct Rules.

**Individual Conduct Rule 1** requires Hilary to ‘act with integrity’. The FCA provides a non-exhaustive list of examples of the type of conduct that would constitute a breach of **Individual Conduct Rule 1**. These include:

1. Misleading (or attempting to mislead) by act or omission a client or the firm for who the person works,
2. Falsifying documents,
3. Providing false or inaccurate documentation or information,
4. Failing to inform, without reasonable cause, a customer or the firm for whom the person works of the fact that their understanding of a material issue is incorrect, despite being aware of their misunderstanding,
5. Providing inaccurate or inappropriate records or returns,
6. Not paying due regard to the interests of a customer, or
7. Acts, omissions or business practices that could be reasonably expected to cause customer detriment.

Lockdown has been a difficult time for many people. In particular, many parents have found juggling home schooling with work very demanding. Whilst this is certainly a relevant factor, it seems difficult to see how this can adequately mitigate Hilary’s actions. Her decision to backdate documents is, at best, a huge lapse in judgement – one which, unfortunately, demonstrates a lack of integrity. The fact that Hilary makes no attempt –

over a matter of months – to make her line manager and/or the Compliance Department aware of this issue can be seen as an aggravating factor.

As we can see from the FCA’s list of examples of the types of conduct that would constitute a breach of the Conduct Rules, Hilary’s conduct is exactly the type of thing that the FCA was concerned about in creating **Individual Conduct Rule 1**. Not only is it a breach of the Conduct Rules, but it is likely to constitute a criminal offence.

**Individual Conduct Rule 2** requires Hilary to ‘act with due skill, care and diligence’, particularly where her activities might affect customers. Among the list of examples provided by the FCA of the types of conduct that would constitute a breach of **Individual Conduct Rule 2** is ‘failing to inform a customer or the firm of material information where the individual was aware of such information and of the fact that they should provide it’. The fact that an ISA deadline has been missed due to a failure to complete all of the requisite documentation should be regarded as ‘material information’. On this basis, it seems likely that Hilary has also breached **Individual Conduct Rule 2**.

**Individual Conduct Rule 4** requires Hilary to ‘pay due regard to the interests of customers and treat them fairly’. Among the list of examples provided by the FCA of conduct which is likely to constitute a breach of Individual Conduct Rule 4 are:

1. Failing to inform a customer of material information in circumstances where the individual was aware, or ought to have been aware, of such information and of the fact that they should provide it, and
2. Failing to acknowledge, or seek to resolve, mistakes in dealing with customers.

Impacted clients should have been notified of the fact that the ISA deadline had been missed because of a failure to complete documentation on time – even if this was (at the time) an innocent mistake. This alone was likely sufficient to constitute a breach of **Individual Conduct Rule 4**. Either way, the subsequent cover-up is clearly a breach of **Individual Conduct Rule 4**.

**Individual Conduct Rule 5** requires Hilary to ‘observe proper standards of market conduct’. In this context, “market” is not restricted simply to standards in relation to “regulated markets”. If we were to consider the relevant market as being either the ‘market for ISAs’ or the ‘financial services market’ more generally, it is arguable that Hilary has also breached **Individual Conduct Rule 5**.

It is clear that Hilary’s conduct was deliberate. As such, she satisfies the requirements of ‘personal culpability’ under the Conduct Rules.

Under normal circumstances, Trusty Wealth Management Ltd would have to notify the FCA of any breach of the Conduct Rules by someone in Hilary’s position 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).

Given Hilary's conduct, the better view would be that the FCA should be notified about the matter immediately.

Consideration should also be given to whether Hilary remains fit and proper to perform her role. Whilst an in-depth discussion of fit and proper testing is beyond the scope of this document, fit and proper assessments rest on three 'pillars':

1. Honesty, integrity and reputation,
2. Competence and capability, and
3. Financial soundness.

In Alice's case, any fit and proper assessment is likely to focus on the first 'pillar' (honesty, integrity and reputation). On the facts of this matter, it seems very difficult to maintain the position that Alice has the requisite honesty or integrity to remain in her role. She has committed, at best, a serious error of judgment and, at worst, a criminal offence. The fact that clients are involved and have suffered losses can only be regarded as an aggravating factor.