

Conduct Rules Scenarios

Non-Financial Misconduct

Scenario

Steve is a star salesman (and Certification Employee) for Best Brokers Ltd.

Following a night out with some friends just before Christmas, Steve has too much to drink. Rather than get a taxi home or book into a hotel, Steve decided to drive home. In his drunken state, Steve drove straight over a roundabout and crashed into a lamp post. Fortunately, nobody else was involved in the incident.

Steve was charged with drink-driving and found guilty.

Steve mentioned the drink-driving charge to his line manager, Jenny. Jenny is the Senior Manager in charge of the sales function within Best Brokers Ltd.

Jenny, aware that her compensation is linked to that of her team and that Steve is her star-performer, chose not to escalate the matter. This was Steve's first transgression and she's pretty sure that he's learned his lesson. Jenny is also aware of the fact that she is under pressure from the board to increase revenue and concludes that nobody will thank her for taking action against Steve.

What conduct rules may have been breached?

- Individual Conduct Rule 1: "You must act with integrity".
- 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".

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.

Steve

Steve’s conduct does not relate to the regulated or unregulated “financial activities” of the firm. As such, it is unlikely to constitute a breach of the Conduct Rules.

Nonetheless, Steve’s conduct may well be relevant for the purpose of assessing whether he remains fit and proper to perform his role due to the fact that non-financial misconduct (including conduct which take place ‘outside of the office’) is a relevant factor in F&P assessments.

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 Steve’s case, any fit and proper assessment is likely to focus on the first ‘pillar’ (honesty, integrity and reputation). Under FIT 2.1, conviction for a criminal offence will not automatically mean that a person is no longer fit and proper. In fairness to Steve, he has informed his line manager of the situation and – whilst his conduct is reckless, cannot be condoned and could damage the reputation of the firm, it is not dishonest per se.

Even if, ultimately, Steve is assessed as remaining fit and proper to perform his role, he may, of course, still be subject to disciplinary action. Again, an in-depth discussion of disciplinary hearings is beyond the scope of this document.

Jenny

Given that Steve's conduct could relate to his fitness and propriety, Jenny should have escalated the matter to HR. Her failure to do so – driven primarily by personal and team financial considerations – may well constitute a breach of **Individual Conduct Rule 1** (“You must act with integrity.”). The FCA cites a number of examples of the types of conduct that would constitute a breach of **Individual Conduct Rule 1**. These include:

1. Misleading (or attempting to mislead) by act or omission the firm for which the person works,
2. Failing to inform, without reasonable cause, the firm for who the person works of the fact that their understanding of a material issue is incorrect, despite being aware of their misunderstanding.

Many of the examples provided by the FCA with respect to **Individual Conduct Rule 1**, relate to ‘misleading in relation to investments’. However, this is not the case with respect to all of the examples provided by the FCA. In fairness, at a high level, it is difficult to conclude that Jenny has acted with integrity in not escalating the matter internally, particularly in light of her underlying motivations. It is not certain what action (if any) would be taken by Best Brokers Ltd against Steve. However, in choosing not to escalate the matter internally, Jenny has effectively robbed Best Brokers Ltd of any opportunity to take action (should it have felt that it was appropriate to do so). This is not solely Jenny's decision to make.

Jenny's failure to escalate Steve's conduct internally may also constitute a breach of **Senior Manager Conduct Rule 1**. **Senior Manager Conduct Rule 1** requires Jenny to ‘take reasonable steps to ensure that the business of the firm for which she is responsible is controlled effectively’.

The FCA also provides a non-exhaustive list of examples of the types of conduct that would constitute a breach of **Senior Manager Conduct Rule 1**. One of those examples is “giving undue weight to financial performance when considering the suitability or continuing suitability of an individual for a particular role”.

Steve's conduct may or may not render him unsuitable for his role. However, the fact that Jenny has not escalated the matter internally – primarily because of Steve's status as a ‘star salesman’ – means that Best Broker Ltd has not even had the opportunity to give consideration to the matter. It is quite possible that Jenny has breached Senior Manager Conduct Rule 1 as a result.

As Jenny is a Senior Manager, pursuant to SUP 10C Annex 2G, any breach of the Conduct Rules would have to be reported to the FCA within 7 days.