SMCR – the unintended consequences

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The SMCR has been in place for dual-regulated firms now since March 2016 and rolls out to all FCA solo-regulated firms from December of this year. But has it had the intended impact and outcomes in improving accountability in firms and the consequent intended improvements in conduct behaviour and culture in those firms? Or has it instead had some unintentional and possibly negative consequences?

As the regime rolls out to the wider financial services community – requiring major commitment of resources and effort and investment in processes and systems – there need to be demonstrable benefits and outcomes to encourage firms further to commit to these.

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So far there is arguably limited evidence that this has indeed been the case and it is difficult to gauge the actual benefits from - or improvements to - firms' attitudes to the SMCR and associated Conduct Rules and their compliance with such.

The FCA recently published the findings of its review into the SMCR in the banking sector, in which it found companies were not always sufficiently tailoring their conduct rule training to suit job roles within the business.

The regulator said many firms were still often unable to explain what a conduct breach looked like in the context of their business and as a result announced it would be upping its supervision of how companies are embedding conduct rules and were meeting their responsibilities under the SMCR.

The review focused on how well the rules had already been embraced by banks, but the FCA said the findings also apply to all solo-regulated firms which will be coming into the regime in December - including advice firms.

The FCA said: “Firms are often using their own values to articulate how they bring the conduct rules to life. However, there was insufficient evidence to be confident that firms have clearly mapped the conduct rules to their values.”

The regulator added: “The conduct rules are a critical foundation for firms' culture and the conduct of individuals. It is essential that staff understand the rules and how they apply to them.”

There has always been a risk that as regulation has become more onerous, it unintentionally hurts recruitment efforts. It is too early to say and there has been little evidence of this. But it is likely that some people, particularly non-executive directors (NEDs), may not be willing to take on the personal responsibility that being a senior manager now requires. And they have good reason to worry. As higher profile enforcement cases become public this may be further the case. The rules though are having some positive outcomes – the first public test of the rules in action was with Barclays boss Jes Staley, who was fined around £642,000 for his attempts to reveal the identity of a whistle-blower. However, as with any legislation, there are unintended consequences that are likely to manifest over time and these cracks are already beginning to show.

Ahead of the extension of the SMCR there has been much to-ing and fro-ing on NED's and whether they are to be governed by the same Fitness and Propriety and COCON regimes as SMF's. There are certain responsibilities that can only be assigned to NED's and then require them to be SMF's. Also the PRA historically treated SMF's differently to the FCA but with the forthcoming extensions of the regime to solo regulated firms – the FCA have had to make changes to how NED's are treated under the regime. So some NED's are fully captured others aren't. It's complex.

A good example is the role of Whistleblowing Champion – a tricky and delicate role to hold and one that seems to be attracting some considerable FCA attention. It is not a prescribed Senior Management Function and yet it is very much on the FCA's radar. A recent disclosure (resulting from a Freedom of Information request) revealed that the FCA are currently investigating up to four NED's for failing to perform their senior management function as Whistleblowing Champion within their financial services firm.

The Whistleblowing Champion function is a case in point regarding the contradictory and often confusing signals from the regulators. Under the FCA Handbook, section SYSC 18.4, all firms are required to appoint one of their non-executive directors to the role of Whistleblowers' Champion. “A firm must allocate to the whistleblowers' champion the responsibility for ensuring and overseeing the integrity, independence and effectiveness of the firm's policies and procedures on whistleblowing (see SYSC 18.3 (Internal Arrangements)) including those policies and procedures intended to protect whistleblowers from being victimised because they have disclosed reportable concerns,” SYSC 18.4 says.

Currently identifying the whistleblowers' champion at any financial services firm is not easy. Firms are not required to put the name of the individual on their websites, nor can the champion be identified by a Senior Management Function (SMF) number on the FCA Register. The decision not to assign an SMF number to the SYSC 18.4 responsibilities was taken by the FCA and Prudential Regulation Authority, not U.K. lawmakers, and so could be changed without primary legislation. However, the FCA says they have no plans to do so. That said – UK lawmakers have called for an overhaul of the Whistleblowing legislation and there is increasing pressure for such individuals to be identified and fully accountable.

Whistleblowers' Champions are intended by the FCA to ensure that allegations are investigated thoroughly and that individuals who speak up are not mistreated. However, a recent report by an All Party Parliamentary Group on Whistleblowing (APPGW) found that more than two thirds of the whistleblowers who gave evidence had faced retaliation and that only 12% of organisations had actually acted on the wrongdoing identified. In other words – there is a lot to be concerned about and firms clearly aren't fully meeting their obligations to either their employees let alone their NED's. In fact – NED's holding this role have every reason to be concerned.

Is this a role that any NED would want to be accountable for? Where is the upside for him/her?

Even with full oversight of the conduct and disciplinary processes and the consequent treatment of whistleblowers within the firm, the NED has to rely on – and trust in – full disclosure from the firm and key management. That is hard to guarantee when you are by definition placed outside of the daily business of a firm. Would you really be prepared to take the fall were a situation – of which you were not fully aware – to be handled incorrectly and the whistleblower unfairly penalized in some way?

NED's rely upon the Board to act as a conduit regarding the information or data regarding matters for which they are effectively accountable. They need therefore to be assured that that their oversight of relevant information is thorough and complete. This is not always the case.

This is just one reason that the role of NED of an FCA regulated firm has become less attractive and recruitment of NED's that bit harder.

And it isn't only the recruitment of NED's that has been affected. Likewise, some senior Compliance professionals in large businesses are concerned about whether they can completely comprehend everything happening on their watch. This along with increased demands for such professionals has pushed Compliance salaries and therefore costs sharply higher and made the recruitment of good Compliance professionals harder.

Additionally, the increased risks associated with being a Senior Manager have also been accompanied by a general decrease in total remuneration for many Senior Managers – the days of the mega bonuses being behind us. The risks are higher the rewards are lower – and if there's one thing these people do understand it's the risk reward relationship.

Those senior managers who do take on SMF roles must also be real team players willing to share collective responsibility and work with all areas of the business to ensure that reasonable steps are taken and evidenced.

In my personal experience this is still not happening as it should and instead can generate some conflict.

A new referencing regime also means that it is no longer possible for a bank to allow a senior manager – or indeed any other Certified employee – who has not met regulatory standards, to resign and move on with a bland agreed reference. This helps prevent the dangers that can arise from the 'rolling bad apple'. Fear of a negative regulatory reference though can prevent some employees moving on and even leaving the industry altogether. This is not the consequence intended – and is also a further potential block on liquidity in the recruitment market.

An important change is that, for many staff, it is their employer that decides if they are 'fit and proper' to perform their role. Decisions can be finely balanced, and, in the absence of defined criteria, there can be a lack of consistency on what might be deemed a breach of conduct rules. The combined effect of all this that in some instances, we are seeing employees fearful of raising concerns or admitting mistakes, which is precisely what the regime was trying to avoid.

Although it is relatively early days, these new accountability rules will no doubt contribute to ensuring that we do not repeat the mistakes of the past. However, we must be careful to ensure that any unintended consequences are nipped in the bud and the necessary assurances and solutions delivered to ease industry concerns and encourage future recruitment of the highest quality candidates to such critical roles.