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Legal Update
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The UK's new regulatory regime for individuals Part 3: The Bank of England and Financial Services Bill 2015

This legal alert will be of interest to all regulated financial services firms. It explains HM Government's intention to extend the UK's new regulatory regime for individuals to all regulated firms and to amend the regime for banks and large investment firms which is due to come into force on 7 March 2016.

1. This is the third in a series of legal alerts looking at the UK's new regulatory regime for strengthening accountability in certain financial services firms, which generally comes into force on 7 March 2016. The first in our series of legal alerts was The UK's new regulatory regime for individuals Part 1: How does it apply to UK branches of EEA and non-EEA banks and PRA-designated investment firms? and the second in our series was The UK's new regulatory regime for individuals Part 2: How does it apply to (re)insurers?.

2. This legal alert considers the Bank of England and Financial Services Bill 2015 (the "Bill") which was introduced into the House of Lords on 14 October 2015. The Bill proposes two significant developments: the extension of the new regulatory regime for individuals to all regulated financial services firms and the removal of the reverse burden of proof which was to be placed on senior managers.

Extension of the regulatory regime for individuals to all regulated financial services firms

3. On 7 March 2016 a new UK regulatory regime for individuals in banks and PRA-designated investment firms will come into force. A modified version for (re)insurers (which we explain in Part 2 of our series of legal alerts as referenced above) is due to come into force in stages on 1 January and 7 March 2016. The key elements of the new regime (which are modified for (re)insurers) are as follows:

   (a) The Senior Managers Regime which imposes new obligations on the most senior decision makers in banks, PRA-designated investment firms and (re)insurers.

   (b) The Certification Regime for employees who are not senior managers but whose actions or behaviour could seriously harm a bank or PRA-designated investment firm, its reputation or customers

   (c) Conduct Rules which will apply to all employees in a bank or PRA-designated investment firm save for those in purely ancillary roles. The application of the Conduct Rules is more limited in respect of employees in (re)insurers.

4. The Bill extends this regime to all "authorised persons", that is all regulated financial services firms, including insurers, investment firms, asset managers, insurance and mortgage brokers and consumer credit firms. This means that the new Senior Managers Regime and Certification Regime will completely replace the existing Approved Persons Regime, which was discredited following the financial crisis. HM Government has taken the view that a more rigorous, comprehensive and consistent approach to the regulation of individuals should be applied across the entire financial services industry.

5. HM Treasury published a policy paper on 15 October 2015[1] which explains that the key features of the regime will be as applied to the banking sector but that the extended regime will be applied proportionately. Accordingly, the regulators will make rules to ensure that the extended regime appropriately reflects the diverse business models operating in the UK market and is proportionate to the size and complexity of firms. The extended regime will replace the Senior Insurance Managers Regime, which currently does not have legislative underpinning, meaning that the regime for (re)insurers will more closely follow the regime for banks and large investment firms.

6. The main effects of the extended regime are expected to be as follows:

   (a) A substantial reduction in the number of individuals in regulated firms who require pre-approval from the Prudential Regulation Authority ("PRA") and/or the Financial Conduct Authority ("FCA").

   (b) An increase in the due diligence that regulated firms must carry out and forms that must be completed before submitting individuals for regulatory pre-approval.

   (c) Most current approved persons below senior management level are expected to become certified persons. Many individuals who are not currently subject to regulatory pre-approval are likely to fall within the Certification Regime also.

   (d) An increase in the due diligence that regulated firms must carry out on individuals in scope of the Certification Regime.

   (e) The application of Conduct Rules to individuals who have hitherto not been within the scope of regulation.

Removal of the reversed burden of proof

7. One of the most controversial aspects of the Senior Managers Regime was the presumption of responsibility which reversed the burden of proof in situations of regulatory breach, meaning that the senior manager who is responsible for a certain area of a firm's business would be presumed to be accountable when regulatory requirements were contravened in that area. The only way to rebut this presumption was for the senior manager to show that he positively took reasonable steps to prevent or stop a contravention. The Bill introduces a statutory duty of responsibility to be applied consistently to all senior managers across the financial services industry which replaces the reverse burden of proof.

8. It is intended that the same underlying obligation as previously envisaged will apply to senior managers to ensure that they take reasonable steps to prevent regulatory breaches in the areas of the firm for which they are responsible but the burden will now be on the regulators to prove that a senior manager has failed to do this, as it is with other enforcement action. The regulators may currently take enforcement action against an approved person if he has contravened the statements of principle that apply directly to him or if he is knowingly concerned in a breach of regulatory requirements by the firm. The Bill amends an additional ground for enforcement in respect of senior managers that was introduced as part of the Senior Managers Regime: the regulators will be able to take enforcement action if they can show that a senior manager failed to take the steps that it is reasonable for a person in that position to take to prevent a regulatory breach from occurring.

9. The abandonment of the reverse burden of proof appears to be a direct response to bank lobbying and the concerns expressed by prospective senior managers. Senior managers will still be required to accept their responsibilities and the regulators remain committed to holding individuals to account when they fail to meet the required standards but senior managers will not now be presumed guilty until they can prove their innocence.

1 *Senior Managers and Certification Regime: extension to all FSMA authorised persons* October 2015

Removal of obligation to report breaches of rules of conduct to regulators

10. The Bill also removes the requirement to report all known or suspected breaches of rules of conduct by any employees subject to the Conduct Rules to the regulators, as this is now considered disproportionately costly.

What happens next?

11. HM Government will amend the commencement order to ensure that the reverse burden of proof and the requirement to report all known or suspected breaches of the Conduct Rules do not come into effect when the main regime comes into force on 7 March 2016.

12. It is intended that the extended regime shall come into force for all regulated firms in the course of 2018. First, however, HM Government must secure the passage of the Bill through Parliament. Only once Royal Assent has been given will the regulators be able to consult on the rules which will introduce unprecedented reforms on the personal responsibility of senior managers in the financial services industry, ensuring that all those in the regulated sector are aware of and accept their responsibilities regardless of the type of firm at which they work..

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