AFME/BBA to response to FCA DP16/4

Overall Responsibility and the Legal Function

09 January 2017

On behalf of their members AFME and the BBA are pleased to respond to the FCA's Discussion Paper DP16/4 Overall Responsibility and the Legal Function.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

The BBA is the leading association for UK banking and financial services representing members on the full range of UK and international banking issues. It has over 200 banking members active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. Eighty per cent of global systemically important banks are members of the BBA, so as the representative of the world's largest international banking, cluster the BBA is the voice of UK banking.

BBA members manage more than £7 trillion in UK banking assets, employ nearly half a million individuals nationally, contribute over £60 billion to the UK economy each year and lend over £150 billion to UK businesses. BBA members include banks headquartered in the UK, as well as UK subsidiaries and branches of EU and 3rd country banks. The BBA is registered on the EU Transparency Register, registration number 5897733662-75.

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1. We write in response to Discussion Paper 16/4 (the ***DP***), following the meeting between AFME/BBA members and the FCA held on 8 December 2016 in relation to the matters raised in the DP.

2. This response should be read in conjunction with the joint AFME and BBA letters of 29 September 2015 and 10 May 2016 in relation to individual accountability for the legal department under the Senior Managers and Certification Regime (***SMCR***).

3. As an introductory point, we wish to make clear that our members welcome the FCA's decision to issue a discussion, rather than consultation, paper with respect to this issue, in order to canvass views before formulating any proposal, and the FCA's willingness to engage in dialogue with the banking industry, including at our recent meeting.

4. For the reasons set out in this letter, our members continue to believe that requiring firms to designate the individual responsible for the management of the legal department as a Senior Manager under the SMCR is plainly not justified by law nor by policy considerations, and would give rise to material risk of harmful unintended consequences.

5. In this letter, we explain:

   (a) The unique character of legal advice.

   (b) The interconnected nature of the management and the giving of legal advice.

   (c) Risk mitigants AFME/BBA members consider to be essential should, contrary to the position of AFME/BBA's members and the requirements of law and policy, the FCA decide to require that an individual be designated as the Senior Manager for the legal department in a bank.

Unique Character of Giving Legal Advice

6. Legal advice occupies a unique position. Unlike every other type of advice, a person who receives legal advice has a substantive right to keep it confidential from Courts and from authorities unless that person chooses to disclose it.

7. This substantive right exists because there is a public interest in persons being able to seek advice on their legal rights, liabilities, and obligations through uninhibited communication with their legal advisors[1]. Such communications ultimately assist compliance with the law by encouraging persons to refrain from making or acceding to unwarranted demands, to comply with their legal obligations and to enforce such compliance by others. If legal advice were not protected in this way, persons might decide not to seek advice, or not to put all relevant facts before their legal advisors, in order to avoid creating material that could be used against them. This would be detrimental to the public interest in compliance with the law.

8. Parliament has chosen explicitly to maintain the unique position of legal advice in the regulatory context. Section 413 FSMA provides that the FCA cannot compel the production of privileged material. The ability of firms to seek advice on their regulatory rights, liabilities, and obligations through uninhibited communication with their legal advisors serves the same public interest identified above. Where a person receives legal

[1] *R v Derby Magistrates Court, ex parte B* [1996] 1 AC 487, 510 (HL).

advice explaining the steps they must take to comply with a regulatory obligation, they are thereby assisted in complying with that obligation, which is in the public interest.

9. The giving of legal advice is therefore different from every other activity, regulated and unregulated, that a bank engages in. It is the only activity that anyone at a bank engages in that is protected as a matter of substantive right from intrusion by Courts and authorities, including the FCA, for fundamental reasons of public policy.

10. In the light of this, we welcome the FCA's recognition in paragraph 3.23 of the DP that the FCA is not seeking to regulate the quality and accuracy of specific legal advice.

The Oversight of Giving Legal Advice

11. If the FCA accepts that the activity of giving legal advice is one that is protected from its scrutiny for fundamental reasons of public policy recognised by the Courts and explicitly endorsed by Parliament in the regulatory context, it is unclear why the FCA considers there to be any justification for requiring an individual to be personally accountable to it for the oversight of that activity:

    (a) First, as a matter of law, where Parliament has explicitly determined that the activity of providing legal advice is one that the FCA is not permitted to scrutinise, it cannot also have intended that an individual should be personably accountable to the FCA for the oversight of that activity. We note in this regard the comments of Lord Newby made during the passage of the legislation that gives effect to the SMCR, which we have set out in our previous correspondence[2].

    (b) Second, it is unclear what policy objective would be served by making an individual personally accountable to the FCA for the oversight of the activity of giving legal advice. Although a failure of oversight might lead to poor legal advice being given, the FCA appears to accept that it would be inappropriate for it to seek to regulate legal advice. It is not clear why it would be appropriate for the FCA to seek to do so indirectly (by the regulation of the oversight of giving advice) when it would be inappropriate for it to do so directly.

    (c) Third, as a practical matter it is obviously not possible to hold an individual accountable for a failing in respect of a bank's activities for which he or she is responsible without first determining that a failure has occurred.

    Where a complaint is made against the individual accountable for the legal department of a bank, the starting point will generally be a complaint about deficiencies in legal advice given. Only then does a question arise about whether a root cause of those deficiencies is a failure of oversight by the individual accountable for the legal department. This is illustrated by two examples given by the FCA at the recent meeting. The first was a situation where defective legal advice had been given by an in-house lawyer, and where that defect had not been picked up because of a failure to follow (or to put in place) an internal procedure for the approval of memorandums of advice. The second was a situation where defective advice was given by an external law firm, where the firm in question lacked the expertise required to give the advice sought. The FCA

[2] See our letter of 29 September 2015 paragraph 2b

suggested that, where a root cause of the first situation was a failure by the bank to follow (or put in place) a proper process, and in the second situation was a failure by the bank to run a panel process that ensured its external law firms had the necessary expertise, it would be appropriate to examine whether the Senior Manager accountable for the legal department had performed their oversight function appropriately. However, in both situations a complaint against the Senior Manager could arise only if the FCA first determined that the advice given was in some way defective. That determination is something the FCA appears to accept it would be inappropriate for it to seek to do.

Risk Mitigants

12. If, notwithstanding the points made by AFME/BBA in this letter, in previous correspondence, and at our meeting, the FCA is determined to require that an individual be personally accountable to it for the legal department of a bank, it is critical that certain protections are put in place in order to mitigate the significant risks that would arise from such a requirement:

    (a) First, the FCA should clearly accept that it does not have the power to and will not seek to regulate the substance of legal advice given by the legal department of a bank, or any other lawyer. We understand this point to be uncontroversial.

    (b) Second, the FCA should make clear that the Senior Manager accountable to it in respect of the legal department is accountable to it for the adequacy of the resourcing of that function but not, for the reasons set out above, for the oversight of the protected activity of giving legal advice. This is particularly important given that the Senior Manager responsible for a function in a bank would often wholly or partially recuse themselves from decision-making about the handling of potential problems in the function for which they are accountable when issues of concern emerge if they were included in the regime. If the General Counsel is treated as answerable for the oversight of all advice given to a bank, he or she may be removed from decision making about the handling of any issue where there is a question or potential question about legal advice. This could significantly impair the ability of the General Counsel to perform their function, which is often of critical importance (to banks and also to regulators) in the circumstances where a potential problem has been identified. To the extent that the FCA also considers that oversight covers more than just resourcing of legal teams (for example, training, MI, processes), we would welcome clarification as to how the FCA sees this working in practice.

    (c) Third, the FCA should undertake not to use privileged material against an in-house lawyer in an enforcement case where the bank chooses to waive privilege. This is critical to ensuring that in-house lawyers in a bank, particularly the Senior Manager subject to the wider set of Conduct Rules, are able to, and (just as importantly) are internally perceived as able to, offer independent and impartial advice, untainted by fear their advice may be used against them. If in-house lawyers are not seen as independent and impartial, this will impede the uninhibited communication which is in the public interest, as set out above, or may drive banks to seek external advice, circumventing the General Counsel and internal legal department. External advice is not a complete substitute for an in-house legal department, given the ability to make connections between different

issues and internal credibility carried by a General Counsel, and the in-house legal department more broadly.

(d) Fourth, the FCA should make clear that it will not put pressure on a bank to disclose privileged material, and will not draw adverse inferences against individuals, in particular against the Senior Manager accountable for the legal department, where a bank chooses not to waive privilege. This is important for reasons for fairness. Privilege belongs to the client (the bank). An individual Senior Manager cannot personally choose to waive it. It is also important because there is already a perception amongst some that the FCA is willing in practice to force the disclosure of privileged material using its position of power as a regulator and banks' desire to maintain good relations with the FCA. Such a perception, if hardened by experience, may have a chilling effect on the willingness of individuals at a bank to communicate in an uninhibited manner with legal advisors, which is in the public interest for the reasons set out above.

(e) Fifth, the FCA should make clear that they have no intention of undermining the duty under the SRA Code of Conduct for lawyers to act in the best interest of their clients and also that SC4 does not apply to a lawyer in respect of information that comes to the lawyer in privileged circumstances, as suggested in paragraph 3.31 of the DP. This suggestion reflects the language Parliament used in section 330 (6) of the Proceeds of Crime Act (***POCA***), when it made clear that the regulated sector reporting obligation under section 330 (1) to (5) of POCA does not apply to a lawyer in respect of privileged communications. The language is therefore an appropriate precedent for the FCA to follow. The reasons for this request are that:

(i) If an individual at a bank knows a General Counsel to be under a personal reporting obligation to the FCA, he or she may be inhibited from communicating freely with the General Counsel, giving rise to the public policy concerns previously identified.

(ii) A General Counsel may regard themselves as precluded from giving legal advice in circumstances where receipt of the information they need to give advice may place them in a position where they are subject to a personal disclosure obligation. This is because a lawyer may consider it inappropriate to act where there is a potential conflict between a personal disclosure obligation and the interests of his or her client, on the basis that this amounts to a conflict for the purposes of the SRA Code of Conduct and/or on the basis that the potential conflict comprises his or her independence as a legal advisor for the purposes of the SPA Principle 3.

(f) Finally, there is currently no guidance from the FCA that General Counsel and others can use to understand what the FCA expects of the Senior Manager accountable for the legal department of a bank, given the historical recognition of that department as falling outside the scope of regulation. If the FCA is to seek to hold individuals personally accountable for the manner in which a legal department is resourced, it needs to articulate its expectations clearly but with appropriate circumspection. Careful consultation about those expectations between all relevant stakeholders will be essential in ensuring they are practical

and reasonable, and respect the unique position of the activity of giving legal advice.

13. AFME/BBA members would welcome further dialogue with the FCA about this important matter. In particular, and as stated above, if the FCA is minded to require an individual to be accountable as the Senior Manager for the legal department in a bank despite the points raised in this letter, we would be grateful for an opportunity to have more detailed discussion about how the risks arising from that position might best be managed before further materials are published by the FCA.

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