

Richard Johnson
Head of Department / Prudential, Governance, Investment & Early Intervention Policy
Strategy & Competition
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

10th May 2016

Dear Richard

Applicability of the Senior Managers Regime to the Head of Legal Function within a Bank

We write further to our previous letter of 29 September 2015 and the FCA's notice published on 27 January 2016¹ regarding overall responsibility for the Legal function under the Senior Managers Regime (**SMR**).

In your notice the FCA noted that whilst you had not included overall responsibility for a firm's Legal function in your indicative list of business activities and functions, responsibility for the management of the Legal function was not excluded, and so the FCA "took the view that many firms would need to identify the role as an overall responsibility Senior Management Function (SMF) when allocating senior management responsibilities if it was not covered by another specific SMF in the firm."

We understand that it is the FCA's intention to consult later this year on this matter. Having discussed this with our members we are concerned that if the Legal function is included within the SMR it could have considerable potentially adverse implications for culture within banks and for the in-house Legal profession. Given our concerns we wanted to write to you in advance of the publication of the forthcoming consultation paper from the FCA setting out our collective views.

The requirements of the SMR and the General Counsel as a Certified Person

Our letter of 29 September 2015 explained why we do not consider that the SMR is applicable to the role of General Counsel / the Legal function within financial institutions.

We do not believe that the legislative or regulatory framework contains any requirement that the role of General Counsel be designated as an SMF within the SMR. The role of the General Counsel and the Legal function is fundamentally an advisory one and not one which involves "management" of the authorised person's affairs (per section 59ZA FSMA). In addition the Legal function is not a "business area" or "management function" of a firm (per SYSC 4.7.8R). Finally, the list of activities, business areas or management functions in Annex 1 to SYSC 4 does not include the Legal function. Nothing in the new FSMA provisions, or the rules promulgated under them, suggests that the SMR is intended to cover the Legal function's principal role and main activity of giving legal advice.

¹ <https://www.fca.org.uk/news/supervisory-intentions-overall-responsibility-legal-function-under-senior-managers-regime>

The role of the General Counsel and contribution to the risk culture of firms

We believe that capturing the General Counsel as a Certified Person (i.e. the current construct) ensures that the General Counsel can continue to contribute positively to institutional culture/risk culture and to regulatory compliance within firms without compromising their ability to meet their other professional responsibilities.

There are considerable benefits to the control environment and culture of firms when an independent, properly mandated and resourced General Counsel is employed within the firm. We believe that designation of the General Counsel as an SMF would dilute those benefits and have undesirable consequences for the firms and the regulators.

A General Counsel, and the Legal function they oversee, needs to be free to counsel a firm and its senior management on legal risks and to provide advisory services including: provision of privileged legal advice related to relevant legal and regulatory regimes; conduct of robust, independent investigations; advocating for the firm in contentious matters and to assist the firm in managing legal risk when exercising judgment in relation to areas of legal uncertainty (including in relation to conflicts of laws) without fear of being constrained by the enhanced SMR responsibilities.

The General Counsel oversees an internalised legal capability that allows them and their team to provide cost efficient and informed legal advice to the board, executives and the firm more widely, including advice related to regulatory compliance. Whilst Legal functions perform a number of roles in the first and second lines of defence, the independent legal advice that the General Counsel and their team provide as their core discipline is independent of all three lines of defence and a key component of a well-managed firm and an effective risk culture. It is critical and beneficial to the industry to protect this independence.

At present the availability of an independent Legal function to offer legally privileged and informed advice to management in navigating complex areas or exercising judgment is well understood and well embedded in the control environments of firms, and this arrangement should not be disrupted. In addition, in the years since the financial crisis, legal teams have become increasingly independent and consolidated under the General Counsel. This ensures that the General Counsel's teams can perform an independent advisory function. The legal team, as an independent advisory function, increasingly makes a major contribution to regulatory compliance and the conduct agenda as well as the broader reputational risk agenda.

The Legal function currently contributes positively to a firm's risk culture, conduct agenda, ethical standards and the making of the right decisions where a firm is faced with dilemmas or in situations where difficult judgments are required. A regime that appears to compromise the independence of that role risks altering how a firm engages with a General Counsel and the Legal function and would result in either less engagement with the General Counsel and the Legal function (and therefore less legal advice being taken, increasing the firm's risk profile), or more use of external counsel. The latter would entail a receipt of external advice that is both privileged and outside the regulatory remit of the regulators and could be given out of context, increasing the firm's legal risk profile and risking poor decisions being made. Legal advice which is forced out to external counsel in this way may be detrimental to the firm's control environment and risk management culture.

The existing regulatory regime for the Legal profession

General Counsels and lawyers employed in their Legal functions are regulated in this jurisdiction either by the Solicitors Regulation Authority (the *SRA*) or by the Bar Standards Board (the *BSB*) or an equivalent and similar overseas body, such as the American Bar Association. The *SRA Handbook*

sets out mandatory principles and a Code of Conduct which applies to all persons regulated by SRA. Similarly, the BSB Handbook sets out a Code of Conduct which applies to all persons regulated by the BSB. The fact that lawyers are independently regulated in this way means that:

- (a) lawyers are already adequately and separately regulated by their own regulatory regimes that impose specific ethical/conduct obligations upon them; for example requiring lawyers to act with integrity, uphold the rule of law, and carry out their role effectively and in accordance with proper governance and sound financial and risk management principles as well as meeting professional standards. These professional standards include an obligation to act in the best interests of the lawyer's clients at all times; and
- (b) the additional layer of regulation placed upon the General Counsel by designating the role SMF would create a complex matrix of conflicting duties for those individuals. We expand on this latter point below.

The special and protected status of the lawyer-client relationship

The special and protected nature of the lawyer-client relationship means that the nature of the General Counsel and the Legal function's role when providing legal advice is distinct from other roles within a firm. When providing legal advice a General Counsel is standing to the side of the three lines of defence model and can be advising each of the lines of defence and the board of directors (and its committees) at any given time. A key concern of our members is that inclusion of the General Counsel role within the SMR would result in an erosion of that protected status, create conflicts of interest and discourage employees of the firm from seeking support from internal legal counsel that often helps ensure a firm is well managed, complies with the law and acts responsibly. In particular, the fundamental right that exists in English law for a client to receive impartial and independent legal advice from a lawyer on a confidential basis would be threatened by the inclusion of the General Counsel role as an SMF and this could, in turn, ultimately weaken the firm's overall risk management arrangements or force them to seek external legal advice which external advice may prove both to lack context and an appreciation of the firm's controls and risk appetites.

Both the SRA Principles and the BSB Code of Conduct require that lawyers "act in the best interests of each client". The same set of professional regulatory requirements place an obligation on lawyers to maintain their independence from external pressures². These obligations go to the core of the lawyer client relationship and would be at risk were the General Counsel to be included in the SMR. If a General Counsel were to be held accountable by the FCA and PRA for legal advice provided to firms she or he would face a personal conflict of interest between protecting his/her own personal position under the SMR and the duty to act in the best interests of his or her client as required by the legal codes, including protecting the legal advice privilege. For example, if the General Counsel needed at any point to demonstrate that 'reasonable steps' have been carried out in the performance of their Senior Management Function as head of the Legal function, there is a real risk that the only meaningful way that this could be demonstrated is for privileged material to be disclosed. However, aside from concerns about the erosion of the fundamental right of legal privilege, discharging the statutory duty would present a serious difficulty to the General Counsel personally as the privilege in the advice they have given is not theirs to waive. Consequently, their ability to demonstrate reasonable steps would be dependent on the firm being willing to waive privilege.

Importantly, that risk of erosion of privilege would be significantly greater if the General Counsel is a Senior Manager as opposed to a Certified Person. Obligations apply to Senior Managers under the Senior Manager Conduct Rules which do not apply to other employees (who are subject to the

² Specifically, SRA Principle 3 states "You must not allow your independence to be compromised", and the BSB Handbook states at CD4 "You must maintain your independence".

Individual Conduct Rules), for example the requirements to take reasonable steps to ensure that the business for which they are responsible is controlled effectively (COCON 2.2.1R) and complies with the relevant regulatory requirements (COCON 2.2.2R). As noted above, in order for a General Counsel as a Senior Manager to demonstrate that reasonable steps have been taken by them, there is a real risk that would require a waiver of privilege. The Individual Conduct Rules by contrast do not require such reasonable steps so would entail much less risk of needing legally privileged material to be produced to demonstrate compliance.

In the Report stage of the Financial Services (Banking Reform) Bill in the House of Lords, concerns were expressly raised that if the provision of legal advice is deemed to constitute carrying on a Senior Management Function that would erode the principle of legal professional privilege. In response, as we noted in our letter of 29 September 2015, Lord Newby on behalf of the Government made clear that *“It is therefore highly unlikely that the regulators would designate being a legal adviser as a senior management function simply because giving advice does not constitute management as set out in the definition of senior management”*. Lord Newby then went on to make clear that the regulators cannot make rules that would trump the protection of legal privilege and in particular the protection provided in section 413 of FSMA that no power under FSMA can be used to require the disclosure of “protected items” including legally privileged material. We consider that the FCA must therefore take proper account of section 413 of FSMA. In particular, we are concerned that any designation of General Counsel as an SMF could then require a General Counsel to disclose legally privileged material in order to comply with their duties in COCON, which would therefore amount to a breach of section 413 and accordingly the application of COCON in that way would be unlawful.

One acute example of both conflicts of interest and erosion of privilege that could occur is where a General Counsel is required to advise Senior Managers on their SMF responsibilities, a potential breach of the Conduct Rules under SMR or the relevant time to report any potential breach. If the General Counsel were themselves a Senior Manager and subject to the SMR, they could be placed in an impossible position in terms of the conflict of interest between their own personal accountability to the firm’s regulators for this advice, and their professional regulatory obligations to the firm.

If a General Counsel were compromised by potentially conflicting duties under the SMR and the SRA/BSB regulations, a firm may be forced to seek external advice independently from the General Counsel. This would adversely impact the General Counsel’s mandate to manage legal risk and influence culture and decision making, thereby creating the risk that less contextualised advice can create. The choice of internal or external advice should be with the firm or the General Counsel and not dictated by regulatory constraints or a risk of waiver of in-house legal privilege.

Conclusion

In summary, we believe the positive way in which the General Counsel’s role and the Legal function currently contributes to a firm’s control environment and culture should be protected and nurtured. For the reasons set out above, we firmly believe that inclusion of the General Counsel role as an SMF would adversely impact the General Counsel’s ability to make those positive contributions.

We trust that you will give full consideration to these points and welcome further discussion with you on this subject prior to the issuance of any consultation paper.

Responsible executives

Simon Hills
British Bankers Association
☎ +44 (0) 207 216 8861
✉ simon.hills@bba.org.uk

Will Dennis
AFME
☎ +44 (0) 20 7743 9341
✉ will.dennis@afme.eu