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Sexual harassment and the SMCR

In keeping with the #MeToo era, sexual misconduct has been flagged by the financial regulator as a relevant matter when assessing the integrity, fitness and propriety of individuals within the industry. **Elliot Francis** explains how this issue relates to the overhauled accountability regime for financial services.

The increased spotlight on sexual harassment and other sexual misconduct in the workplace continues to be a driver for all industries to reconsider and reshape the way such matters are dealt with. It is no longer something employers can sweep under the carpet; this is in part due to the #MeToo movement and the work of advocacy groups such as the Women and Equalities Committee who continue to act as a voice for change.

Financial services have long been considered a particular area of risk in relation to conduct matters but in recent years the attention has been largely on high-profile banking conduct scandals like PPI mis-selling and LIBOR manipulation. Historically, allegations of sexual misconduct have been viewed by firms as an issue simply for Human Resources and not the Financial Conduct Authority.

However, the FCA's interest in tackling sexual conduct is not new and having already implemented the Senior Managers and Certification Regime, the regulator sees this as a way to improve culture, governance and accountability within financial services firms. The SMCR has been in place for banks and Prudential Regulation Authority-designated investment firms for over two years and was recently extended in December 2018 to cover insurers. As of 9 December 2019, the SMCR will be extended further to cover all 'FCA only' authorised firms and additional/revised measures will need to be taken into account by firms already subject to the SMCR. The FCA's website states that these changes are being introduced, "*with the aim of reducing harm to consumers and strengthening market integrity*". [1]

The FCA has been keen to emphasise publicly that sexual harassment falls within the scope of its regulatory framework and as part of preventing harm to consumers and markets, this includes tackling sexual misconduct at its source rather than simply as an afterthought. Addressing the Women and Equalities Committee in relation to their work on sexual harassment in the workplace on behalf of the FCA, Megan Butler, executive director of supervision at the regulator, stated, "*sexual harassment and other forms of non-financial misconduct can amount to a breach of our Conduct Rules, which include the requirement to act with integrity, and the SMCR imposes requirements on firms to notify us of Conduct Rule breaches*". [2] Part of the SMCR's function is to assist financial services firms in equipping themselves with the tools and processes to train, monitor, investigate and combat sexual misconduct themselves but with the knowledge that the FCA is working with firms on this at all levels.

The extension of the SMCR takes into account the variations in size, risk and complexity of financial institutions and tailors the regime according to whether an entity is considered a 'limited scope firm' (eg, sole traders), a 'core firm' (eg, certain insurance intermediaries) or an 'enhanced firm' (eg, CASS large firms). This means that certain elements of the SMCR that apply to enhanced firms will not apply to limited scope firms and in some instances core firms; it will depend on what activities are carried out and what permissions are required. In relation to other areas such as the certification, fitness and propriety, as well as conduct rule requirements, these will apply in ostensibly the same way for all three categories.

Senior managers

Senior managers are individuals who are the most senior people in a firm, with the greatest potential to cause harm or impact upon market integrity. Firms that are not already covered by the SMCR will need to ensure that every senior manager has a document setting out their role and responsibilities (a 'Statement of Responsibilities').

While many firms have already implemented the SMCR, there will be a number of new measures introduced on 9 December 2019, including an extension to the list of responsibilities dictated by the FCA in addition to a senior manager's inherent responsibilities ('Prescribed Responsibilities'). In particular, the Prescribed Responsibilities will include a responsibility for senior managers in core and enhanced firms to monitor the "*performance by the firm of its obligations in respect of notifications and training of the Conduct Rules*". [3] This will place individual accountability on senior managers for a firm's adherence to this. Measures to ensure that employees are being trained, informed and are aware of the Conduct Rules relevant to their position before the extension of the SMCR should already be in place.

While Prescribed Responsibilities will only apply to core and enhanced firms, the statutory 'Duty of Responsibility' (under the Financial Services and Markets Act 2000) will apply to all regulated firms and this means that a senior manager may be held responsible by the FCA if a breach of a regulatory requirement takes place in the senior manager's area of responsibility and the senior manager failed to take reasonable steps to prevent or stop the breach. As stated by Megan Butler, "*sexual harassment and other forms of non-financial misconduct can amount to a breach of [the] Conduct Rules*". [4]

The burden of proof will be for the FCA to show that a senior manager failed to take reasonable steps to prevent or stop a breach, but the Duty of Responsibility requires positive actions to be taken by senior managers in order to be able to justify a reasonable steps defence. To that end, the FCA has provided guidance in the FCA Handbook (at DEPP 6.2.9E) which includes a non-exhaustive list of steps that a person could reasonably be expected to take in order to avoid a contravention. Ensuring that appropriate policies and procedures are in place and are implemented effectively in order to educate and retrain staff (where necessary) about the risks of sexual harassment in the workplace and the importance of reporting potential instances to appropriate people in the business, will all go towards showing that a senior manager has taken reasonable steps to avoid any breach. However, each case will be assessed on the facts and circumstances – therefore a reasonable steps defence that is considered appropriate in one instance may not be considered adequate in another. It is hoped this will help foster a more robust and preventative attitude towards sexual misconduct at work. A senior manager's actions in this respect may also be taken into account when assessing whether a person is fit and proper to perform their role.

A number of roles with existing approval under the Approved Persons Regime will automatically be converted and categorised as a senior management function and will require a Statement of Responsibility, be subject to a Duty of Responsibility and potentially Prescribed Responsibilities. However, there will be a number of existing roles approved under the APR that fall outside of the SMCR; these roles will no longer require approval of the FCA but some will fall within the Certification Regime.

Certification Regime

Under the SMCR a framework will be introduced to cover certain functions (known as 'certification functions') where the individual concerned is not a senior manager but holds another key position that could impact on customers, the firm and/or market integrity (the 'Certification Regime'). Firms will need to ensure that people carrying out these functions, which include but are not limited to, significant management functions, proprietary traders and material risk takers, are suitable to do their job and must carry out an assessment of that individual's fitness and propriety. This is required at least once a year. A number of roles that will fall under the Certification Regime may have previously been approved by the FCA but this will no longer be the case as of 9 December 2019. The FCA's aim here is to reinforce that firms, not the regulator, are responsible for making sure that individuals are fit and proper to carry out their respective roles.

Fitness and propriety

The fitness and propriety test will apply to all regulated firms and will be extended to cover staff certified under the Certification Regime as well as senior managers and NEDs (whose role is not an approved role by the FCA). Criminal record checks will be mandatory in respect of all senior managers and regulatory references will be required from all senior managers, certified employees under the Certification Regime and non-approved NED roles. The regulatory reference check will cover the past six years of an individual's employment history. Furthermore, in assessing a person's fitness and propriety firms will have to consider an individual's honesty, integrity and reputation (this is not a prescriptive list). Sexual misconduct may have an adverse impact on an individual's honesty, integrity and reputation for the purpose of this assessment.

Conduct Rules

The Conduct Rules will replace the current Statements of Principle and will set a benchmark for the expected behaviour of senior managers, certified employees under the Certification Regime and non-approved NED roles. The Conduct Rules are two tiered and while the second tier only applies to the roles mentioned above, the first tier shall apply effectively to all other employees of regulated firms (with the exception of 'ancillary' employees such as post-room staff and receptionists). This is significant not least because a breach of the Conduct Rules will be grounds for disciplinary action. The first two Conduct Rules require a person to, (1) act with integrity and (2) act with due care, skill and diligence. Clearly, instances of sexual misconduct or failing to prevent sexual misconduct would be considerations under these two Conduct Rules. Firms will have to report any disciplinary action taken to the FCA and in respect of senior manager roles a report must be made within seven days of disciplinary action being taken. For all other applicable staff, a report must be made annually in October.

Conclusion

It is essential that firms all take a proactive approach against sexual misconduct. The extension of the SMCR is a positive step in that it includes changes which require firms and individuals to take more responsibility in combating sexual harassment and/or misconduct in financial services. The focus has shifted to ensure all firms consider the treatment of such conduct in equivalent terms to the traditional risks associated with the sector. The requirement to notify the regulator will give the FCA more visibility in respect of a firm's working culture.

Notes

[1] *www.fca.org.uk/firms/senior-managers-certification-regime/solo-regulated-firms*.
[2] *www.fca.org.uk/publication/correspondence/wec-letter.pdf*.
[3] *www.fca.org.uk/publication/policy/guide-for-fca-solo-regulated-firms.pdf*.
[4] *www.fca.org.uk/publication/correspondence/wec-letter.pdf*.

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