Reversing the Burden: Preventing Malfeasance in the Financial Services Industry by Presuming Fault

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I. INTRODUCTION

During the early 2000's, the United Kingdom enacted the Approved Persons Regime (APR) in an effort to regulate the financial services market.[1] The APR was long criticized for its inability to effectively regulate the market, and its vulnerabilities were revealed in the wake of the 2007–2008 market crash.[2] Not only did these regulations not prevent the crash, but because of the manner in which the Regime operated, those who were responsible for the crash simply could not be identified.[3] This was largely due to the fact that the APR really only served as a regulatory barrier to individuals holding particular roles in the financial services market, but once the barrier was passed, the APR lacked any teeth.[4] Thus, once an individual was approved for their role, there was no way to regulate

1. *See* Freshfields Bruckhaus Deringer LLP, *An outline of the approved persons regime*, LEXOLOGY (Feb. 20, 2007), http://www.lexology.com/library/detail.aspx?g=e13eea9d-096f-4c10-88cf-d325fc973064 (noting that the APR came into existence with the Financial Services and Markets Act 2000).

2. *See* PARLIAMENTARY COMMISSION ON BANKING STANDARDS, CHANGING BANKING FOR GOOD, 2013–14, HC 175–II, ¶ 549–65 (UK) [hereinafter CHANGING BANKING FOR GOOD].

3. *See id.* ¶ 549–52, (noting that very few individuals were actually penalized after the market crash).

4. *See id.* ¶557-58, (noting that the APR was a "one-shot" approach to regulation, relying solely on

their conduct to prevent malfeasance.[5] Another key problem with the APR was that it was nearly impossible to tell which individuals in which firms were responsible for specific tasks, so when the time came to penalize those responsible, regulators had no idea who they were.[6]

The Senior Managers and Certification Regime (SMCR) has since been chosen to replace the APR and its many defects. This SMCR still operates as a regulatory barrier to individuals who wish to hold key roles within a firm, requiring the relevant regulatory agency to approve or deny the individual based on a number of criteria.[7] Most importantly, however, is that the SMCR goes further than just serving as a barrier to entry. The SMCR purports to impose a continuing duty for the highest levels of management to diligently supervise all of their subordinates in an effort to prevent any future malfeasance.[8] The SMCR also requires individual firms and those at the highest levels of management to specifically map out the delegation of duties within the firm, so that if malfeasance does occur, the regulatory agencies know exactly who to hold responsible.[9] These changes have essentially turned each private firm into a regulator of itself, and comparisons to the Compliance Management Systems ("CMS") required for financial firms in the United States are particularly salient.[10]

While the SMCR should be a vast improvement over the APR, several changes to the SMCR have taken shape since it was originally proposed.[11] Most notably, the original SMCR implemented a reverse-burden of proof, requiring individuals at the highest levels of management to actually prove that they took reasonable steps to prevent and mitigate any malfeasance that occurred under their watch.[12] This requirement has since been removed.[13] In addition, the original SMCR imposed a duty on those managers to report

preventing unfit individuals from entering key positions, but doing nothing after they were approved for those positions).

5. *See id.*

6. *See id.* ¶ 553-56.

7. *Financial Services Firms Urged to Get Ready for 2018 as Law Extending Senior Managers' Regime Receives Royal Assent*, MAYER BROWN 2 (May 2016), https://www.mayerbrown.com/files/Publication/db177aa1-4036-481f-a412-b84193c9e51f/Presentation/PublicationAttachment/fc06b279-da82-44fd-b5b5-c442c5babd9d/160513-FSRE-Senior-Managers-Legal-Update.pdf [hereinafter MAYERBROWN].

8. *Id.*

9. Shazia Khan Afghan, *The new Senior Managers Regime, Certification Regime and Conduct Rules in the UK: The Sharpening of the "Sword of Damocles"?*, 4 MORAL CENTS , 5, 7–10 (Summer/Fall 2015).

10. *See Compliance Management Systems (CMS)*, FDIC: DIVISION OF DEPOSITOR AND CONSUMER PROTECTION, https://www.fdic.gov/regulations/resources/director/presentations/cms.pdf (last visited Oct. 19, 2017) ("The Board of Directors is ultimately responsible for developing and administering a CMS that ensures compliance with federal consumer protection laws and regulations.") [hereinafter *Compliance Management Systems*].

11. *See generally* Barnabas Reynolds & Reena Agrawal Sahni, *Individual Accountability: The Senior Managers and Beyond*, BANKING PERSP. , https://www.theclearinghouse.org/research/2015/2015-q4-banking-perspectives/individual-accountability-uk-us (last visited Oct. 19, 2017) (noting that the presumption of responsibility has been removed); Sarah Hitchins, *Senior Managers Regime: Other last-minute changes*, ALLEN & OVERY (Oct. 19, 2015), http://www.aoinvestigationsinsight.com/senior-managers-regime-other-last-minute-changes/ (noting that the requirement to report breaches has been removed).

12. John Ahern et al., *UK Senior Managers Regime to Extend to All FSMA-Authorised Firms*, JONES DAY (Oct. 2015), http://www.jonesday.com/uk-senior-managers-regime-to-extend-to-all-fsma-authorised-firms-10-29-2015/.

13. *Id.*

any actual or suspected breaches of specific rules of the SMCR within seven days, but now those managers have no specific duty to report actual or suspected breaches.[14]

This Note will explore how these two changes in tandem may affect the efficacy of the SMCR as a whole. Part II will delineate the history of the APR and the SMCR, first looking at the APR and how it specifically operated, second looking at the problems associated with it, and finally looking at how the SMCR is supposed to operate and how that may improve upon the APR. Then, this analysis will include comparisons to the Compliance Management Systems required for U.S. financial firms. Part III will then analyze the ramifications of the removal of the reverse-burden of proof and the reporting requirement, specifically the isolated effects of removing each of them individually, and as the tandem effect of removing them together. This analysis might demonstrate how that SMCR could work in practice. Part IV will then recommend the reinstatement of the reverse-burden of proof. It will first look generally at the benefits of the reverse-burden, then specifically at how it would help cure the absence of the reporting requirements. Finally, it will recommend that U.S. firms looking to properly implement CMS look to portions of the SMCR for guidance.

II. BACKGROUND

In response to the 2007–2008 financial crisis, the United Kingdom (UK) passed a number of reforms aimed at restoring public confidence in the private banking sector.[15] Specifically, the aftermath of the financial crisis revealed an open culture devoid of individual accountability, which not only led to the financial crisis, but also has resulted in very few of those responsible for the crisis from facing any real consequences.[16] In an effort to promote individual accountability, individuals working in the financial services industry have been regulated through the APR, but the program has long been criticized for its ineffectiveness.[17] In response, the UK has recently decided to extend the SMCR to the Financial Services Industry as a whole.[18]

A. The Approved Persons Regime

The APR prohibited financial service firms from allowing any employee to perform a "controlled function" without the pre-approval of the Financial Services Authority

14. *Senior Managers Regime—proposed "u-turn" on the Presumption of Responsibility?*, ALLEN & OVERY, http://www.allenovery.com/publications/en-gb/lrrfs/uk/Pages/Senior-Managers-Regime-%E2%80%93-proposed-u-turn-on-the-Presumption-of-Responsibility.aspx (last visited Oct. 19, 2017) [hereinafter *Senior Managers Regime*].

15. *Senior Managers and Certification Regime: extension to all FSMA authorised persons*, HM TREASURY 1, 3 (Oct. 2015), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468328/SMCR_policy_paper_final_15102015.pdf [hereinafter HM TREASURY].

16. Abi Olapade, *The Senior Management Regime takes shape*, FINEXTRA (Apr. 12, 2016), https://www.finextra.com/blogposting/12461/the-senior-management-regime-takes-shape.

17. *See* HM TREASURY, *supra* note 15, at 4 ("HM Treasury's choice of wording is a reflection on the years of criticism levied against the current ARP.").

18. The statute was previously limited to the banking sector, which generally did not include insurers, investment firms, asset managers, insurance and mortgage brokers and consumer credit firms.

(FSA).[19] Essentially, the APR required an employer to submit an application to the FSA on the employee's behalf for *each* controlled function they were to perform.[20] The FSA would then assess whether the employee was "a fit and proper person" to perform the controlled function that the application concerned.[21] Assuming pre-approval was granted, the FSA was still capable of withdrawing their approval of an employee at any time if it felt that the employee was no longer fit and proper to perform that function.[22] The FSA was also able to preemptively prohibit any person from performing controlled functions, regardless of whether an application had been submitted, based on the FSA's determination that the individual was not fit and proper to perform the function(s).[23]

Controlled functions were not necessarily specifically defined, but rather fell under any one of three broad "conditions."[24] The first condition was whether the function was likely to enable the employee to exercise a significant influence on the conduct of the employer's affairs.[25] The second condition was whether the function would involve the employee dealing with customers of the employer in a manner substantially connected with regulated activities.[26] The third condition was whether the function would involve the employee dealing with property of customers of the employer in a manner substantially connected with regulated activities.[27]

In assessing whether an employee was fit and proper to perform the specific function, the FSA looked at three broad criteria: (1) honesty, integrity, and reputation of the employee[28]; (2) "competence and capability" of the employee "to perform the controlled function"[29]; and (3) the "financial soundness" of the employee.[30] In assessing the first factor, the FSA considered not only criminal offenses and prior contraventions of FSA rules, but also any adverse findings in civil proceedings, any involvement in investigations or disciplinary proceedings by any regulatory body, any complaints against the employee, and prior dismissals and resignations.[31] The employee's candor and truthfulness throughout the process was also a relevant consideration to the first factor.[32] In assessing the second factor, the FSA looked at whether the employee had the experience and training necessary to perform the specific function.[33] In assessing the third factor, the FSA

19. *Approved persons*, FIN. CONDUCT AUTHORITY (May 12, 2015), https://www.fca.org.uk/firms/approved-persons [hereinafter *Approved persons*].

20. *Id.*

21. *Fitness and propriety*, FIN. CONDUCT AUTHORITY (May 12, 2015), https://www.fca.org.uk/firms/approved-persons/fitness-propriety [hereinafter *Fitness and propriety*].

22. *Change or cancel an approval or controlled function*, FIN. CONDUCT AUTHORITY (May 12, 2015), https://www.fca.org.uk/firms/approved-persons/change-cancel-approval-controlled-function [hereinafter *Change or cancel*].

23. *Id.*

24. Financial Services and Markets Act 2000, c. 8, § 59 (Eng.).

25. *Id.* § 59 (5).

26. *Id.* § 59 (6).

27. *Id.* § 59 (7).

28. *Fitness and propriety*, *supra* note 21 (listing "honesty (including openness with self-disclosures, integrity, and reputation)" as one of three factors considered when evaluating a candidates fitness and property).

29. *Id.*

30. *Id.*

31. Freshfields Bruckhaus Deringer LLP, *supra* note 1.

32. *Id.*

33. *See* Financial Services and Markets Act 2000, c. 8 § 51 (2); Freshfields Bruckhaus Deringer LLP, *supra*

considered whether the employee was subject to an outstanding debt or had not satisfied previous debts within a reasonable period of time, as well as any prior arrangements with creditors, bankruptcies, or sequestration of assets.[34]

B. Criticisms of the Approved Persons Regime

The APR has been continually criticized for its inefficacy in regulating the financial services industry.[35] One of the principle criticisms of the APR is that it simply did not regulate enough individuals within the financial services industry.[36] In other words, the "controlled function" test was far too narrow to include the bulk of employees who ought to be regulated more closely.[37] As Parliament itself noted, this perceived under-inclusivity was mainly due to the nature of the APR.[38] Pre-approval mechanisms require a process of heavy factual investigation, which can be both extremely difficult and costly.[39] Thus, these practical limitations imposed a serious limitation on how inclusive the APR could be.[40]

Another principal criticism of the APR was that, even for those who were regulated under the APR, they still often went unpunished after violations occurred because of the front loaded—one-shot—approach that the APR took.[41] Violations often went unpunished under the APR because it was unclear who was responsible for specific violations.[42] This problem was largely due to the fact that the controlled functions test did not look at specific responsibilities, but rather created broadly-defined roles which the FSA then considered to determine if the employee was suitable to perform.[43] Because the controlled functions test did not inquire as to the specific responsibilities of employees, it was extremely difficult to identify which employees were responsible for specific violations when they occurred.[44] While this was extremely problematic in itself because it plainly eschewed the entire notion of creating and enforcing individual accountability, it was especially problematic because as the size of the firm increased and the number of individuals who could have potentially been responsible for a violation increased in step, it became even harder to identify which individuals were responsible for the violation.[45] This was especially problematic because the larger financial service providers were likely to produce the greatest market harm from their violations; in essence, the APR could not regulate the type of firms which were largely

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note 1 (requiring a statement of the desired variation and of the regulated activities the applicant proposes to carry on if permission is varied).

34. Freshfields Bruckhaus Deringer LLP, *supra* note 1.

35. *See* CHANGING BANKING FOR GOOD, *supra* note 2, ¶ 559–65 (noting the various problems with the APR).

36. *See id.* ¶ 549–52 (noting the lack of inclusivity within the financial services industry necessary to effectively regulate it).

37. *Id.*

38. *See id.* ¶ 557–58 (noting that the "one-shot" approach focuses only at the approval stage, with no enforcement mechanisms after approval).

39. This burden is amply evidenced by the fact that the number of intensive interviews of applicants had significantly decreased from the inception of the APR. *Id.* ¶ 552.

40. CHANGING BANKING FOR GOOD, *supra* note 2, ¶ 552.

41. *Id.* ¶ 557–58.

42. *See id.* ¶ 553 (noting the APR created problems of complexity in structures and a lack of clarity in structures about which senior management are directly responsible for individual decisions).

43. *Id.* ¶ 556.

44. *Id.*

45. CHANGING BANKING FOR GOOD, *supra* note 2, ¶ 553.

responsible for the 2007-2008 market crash.[46]

The front-loaded approach of the prior-approval focus created a number of other more discrete problems.[47] For instance, even assuming that it was clear that a specific, approved employee was not fit to carry out a specific function, it was very difficult to remove them after prior approval.[48] This was because the APR placed the burden on the applicant of proving that they were fit to perform the controlled function, but once approval had been given, the burden switched to the FSA to prove that the employee was not fit to perform the controlled function.[49] This aspect was problematic due to the front-loaded approach described above; the approval stage was really the only point in time at which the APR regulated anything because of the problem of not being able to identify individuals responsible for violations after they occur.[50] This reversal of burdens was extremely problematic in the case where the nature of an approved function changes.[51] An employee whose responsibilities remained in the same *category* that they were approved for but received a much-larger degree of responsibility or autonomy did not have to re-apply under the APR, and was thus entitled to the reverse burden of proof even though the employee's potential to cause harm had greatly increased in ways which were not considered at the initial approval stage.[52]

C. Remedy: Extension of the Senior Managers and Certification Regime

As a result of the number of problems associated with the APR, the SMCR will be extended to all sectors of the financial services industry completely by 2018.[53] This extension consists of three key features: Senior Management Regime (SMR), Certification Regime, and Rules of Conduct.[54] The SMCR essentially turns each individual firm into a quasi-regulator, requiring firms themselves to put procedures into place to ensure their own compliance with the SCMR, while the actual regulatory bodies will be able to narrowly focus on the most senior staff to ensure that they are quasi-regulating properly.[55] The ability to delegate much of the regulatory tasks to individual firms is an extremely important aspect of the SMCR, because it allows the SMCR to bring many more individuals under its regulatory authority, and thus likely improves upon one of the key problems with the APR.[56]

The SMCR is spearheaded by the SMR, which places a large responsibility on "Senior Managers" to make sure that the firm is compliant with the SMCR as a whole.[57] The SMR will directly replace the APR,[58] requiring the pre-approval of Senior Managers that hold

46. *Id.* ¶ 655.
47. *Id.* ¶ 557–58.
48. *Id.* ¶ 558.
49. *Id.*
50. CHANGING BANKING FOR GOOD, *supra* note 2,.¶ 553–56.
51. *Id.* ¶ 558.
52. *Id.* ¶ 558
53. HM TREASURY, *supra* note 15, at 15.
54. *Id.* at 7.
55. Ahern et al., *supra* note 12.
56. *See* CHANGING BANKING FOR GOOD,, *supra* note 2, ¶ 634 (noting the problematic approach of the APR and how the SMCR has improved upon those deficiencies).
57. *Id.* ¶ 616.
58. Individuals that had already been approved under the APR have been "grandfathered" into performing SMFs if they were moving to equivalent roles in the new regime. MAYERBROWN, *supra* note 7, at 2.

key roles and responsibilities in the financial services industry.[59] Those key roles have been delineated under the 18 different "Senior Management Functions" (SMF's), which offer relatively specific roles and tasks undertaken which qualify someone as a Senior Manager.[60] After determining the employees who are performing SMF's, the firm must further give a detailed description of the specific responsibilities of each of the Senior Managers, known as a "Statement of Responsibility."[61] Statements of Responsibilities must be resubmitted whenever there is a 'significant change' in the Senior Manager's duties.[62] Firms must also submit and annually update a "Responsibility Map," which maps out the organizational structure of the regulated activity and accounts for which employees hold specific responsibilities.[63]

Two of the most controversial aspects of the SMCR have come in the forms of the extra liability that Senior Managers face.[64] First, Senior Managers were initially charged with a "presumption of responsibility."[65] In the event of a breach of Conduct Rules, the Senior Manager would have to prove that they took all reasonable steps to prevent a breach from occurring or continuing.[66] This presumption was seen as especially important to avoid the common scenario "where it becomes very difficult for regulators to definitely demonstrate whether X or Y individual, took reasonable steps to prevent their firm breaching a particular regulatory requirement in their business area."[67] After much outrage by the private sector, the presumption of responsibility has been replaced by the "duty of responsibility," which still requires Senior Managers to take all reasonable steps to prevent a regulatory breach from occurring or continuing but recasts the burden onto the regulatory agency to prove that reasonable steps were not taken.[68] A Senior Manager will be guilty of misconduct if the regulatory agency proves, based on the "balance of probabilities,"[69] that: (1) the Senior Manager's firm committed a regulatory breach[70]; (2) the Senior Manager was a Senior manager at the time of the regulatory breach[71]; (3) the Senior Manager was responsible for the management of any of the firm's activities in relation to which the breach occurred; and (4) the Senior Manager did not take such steps as a person in the

59. Ahern et al., *supra* note 12.

60. MAYERBROWN, *supra* note 7, at 2.

61. Press Release, Financial Conduct Authority, FCA publishes final rules to make those in the banking sector more accountable (July 7, 2015), https://www.fca.org.uk/news/press-releases/fca-publishes-final-rules-make-those-banking-sector-more-accountable.

62. *The new accountability regime*, NORTON ROSE FULBRIGHT (Dec. 2014), http://www.nortonrosefulbright.com/knowledge/publications/123899/the-new-accountability-regime#section2 [hereinafter NORTON ROSE FULBRIGHT].

63. *Id.*

64. *Senior Managers Regime*, *supra* note 14.

65. *Id.*

66. *Id.*

67. Martin Wheatley, Chief Executive, Fin. Conduct Authority, Address at the ResPublica Vocational Banking Event, Debating Trust and Confidence in Banking (May 28, 2015), https://www.fca.org.uk/news/speeches/debating-trust-and-confidence-banking [hereinafter Debating Trust].

68. Afghan, *supra* note 9, at 16.

69. The balance of probabilities is the equivalent of the preponderance of the evidence standard in the United States. HHJ Stephen Davies, *Proof on the balance of probabilities: what this means in practice*, THOMSON REUTERS (Oct. 22, 2009), http://uk.practicallaw.com/2-500-6576?service=ld (noting that the balance is satisfied if "on the evidence, the occurrence of the event was more likely than not").

70. Reynolds & Sahni, *supra* note 11, at 78.

71. *Id.* at 78–79.

senior manager's position could reasonably be expected to take to avoid the contravention occurring or continuing.[72]

The second controversial aspect of the SMCR is the imposition of criminal liability for certain Senior Managers who work in a banking institution.[73] These Senior Managers will be subject to a criminal offense if they made a reckless decision which caused a bank to fail.[74] The Senior Manager must have been aware at the time the decision was made that its implementation may cause the institution to fail, and "the decision must fall significantly below what could reasonably be expected of someone in their position."[75] The offense carries a penalty of up to 12 years in prison and/or an unlimited fine, and is judged against the traditional "beyond a reasonable doubt" standard.[76] However, the government has declared that "such prosecutions will be rare."[77]

The Certification Regime shifts the focus from Senior Managers to cover all other employees whose roles could still cause "significant harm to the firms or its customers."[78] Unlike Senior Managers, the employees covered by the Certification Regime do not need to be pre-approved by the FCA.[79] Rather, the employer itself needs to take reasonable care in annually certifying that these employees are fit and proper to perform their respective functions.[80] This means that firms will be burdened with the task of developing and implementing procedures to assess the fitness and propriety of a large number of their employees both at the time of hiring and on an ongoing basis.[81] Firms assessing the fitness and propriety of its employees do not have to implement one general test for all employees covered by the certification regime, but rather have the flexibility to implement varying degrees and mechanisms based on specific roles—the more risk a specific role exposes the firm and its customers to, the more intensive the assessment should be, and vice-versa.[82]

The Conduct Rules supply the teeth of the new Regime by setting out the conduct that financial service providers are expected to meet, extending liability to many lower-level employees within firms.[83] The regulatory agency can take enforcement action against individuals personally if they have breached any Conduct Rules.[84] These rules apply to Senior Managers and employees covered under The Certification Regime, as well as all other employees who perform a role that is specific to the financial services business of the firm.[85] For example, a receptionist would likely not be subject to the Rules of Conduct.[86] The purpose behind the extension of these rules to so many employees within a firm is to

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72. *Id.* at 79.

73. *Id.* at 80.

74. *Id.*

75. NORTON ROSE FULBRIGHT, *supra* note 62.

76. Reynolds & Sahni, *supra* note 11, at 80.

77. NORTON ROSE FULBRIGHT, *supra* note 62.

78. MAYERBROWN, *supra* note 7, at 2.

79. *FCA publishes final rules to make those in the banking sector more accountable*, FIN. CONDUCT AUTHORITY (July 7, 2015), https://www.fca.org.uk/news/press-releases/fca-publishes-final-rules-make-those-banking-sector-more-accountable.

80. *Id.*

81. Afghan, *supra* note 9, at 17.

82. *Id.*

83. *See* MAYERBROWN, *supra* note 7, at 2 (noting that the conduct rules apply to employees apart from Senior Managers or those under the Certification Regime).

84. Afghan, *supra* note 9, at 20.

85. MAYERBROWN, *supra* note 7.

86. *Id.*

foster a culture change and bring a "deeper understanding of what is and is not acceptable behavior."[87] It is suggested that training programs be implemented to ensure that employees at all levels understand the Conduct Rules which apply to them.[88] The general Rules of Conduct are drawn from the FCA Code of Conduct, focusing on acting with integrity, diligence, in the interests of customers, complying with regulators, etc.[89] Aside from the general rules, there are more specific rules depending on whether the employee is a Senior Manager.[90] Senior Managers have four specific Conduct Rules that they must carry out: (1) they "must take reasonable steps to ensure that the business of the firm for which they are responsible is controlled effectively"; (2) they "must take reasonable steps to ensure that the business of the firm for which they are responsible complies with the relevant requirements and standards of the regulatory system"; (3) they "must take reasonable steps to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibility effectively"; and (4) they "must disclose appropriately any information of which the FCA or PRA would reasonably expect notice."[91]

The Conduct Rules were initially to be enforced by a requirement to report breaches to the regulatory agency.[92] All employees covered by the Conduct Rules had a duty to report actual or suspected breaches of the Conduct Rules, but again, Senior Managers were subject to a far greater duty to report breaches.[93] Actual or suspected breaches of the Rules of Conduct by Senior Managers had to be reported to the regulatory agency within seven days, whereas actual or suspected breaches of the Rules of Conduct by anyone else who is subject to them had to be reported quarterly.[94] Many firms saw the reporting requirement as particularly onerous, mainly due to the inclusion of the duty to report "suspected" breaches.[95] Firms feared that they would be required to be continuously reporting individuals to the regulators, with many allegations turning out to be unfounded.[96] The regulators themselves responded to this and related criticisms by watering down their proposals for reporting requirements.[97] Rather than reforming the reporting requirements, the government removed all reporting requirements from the SMCR.[98] It remains unclear how the Conduct Rules are going to be enforced in the absence of any reporting requirement.[99]

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87. *The FCA and PRA Senior Managers and Certification Regime—The new landscape*, ALLEN & OVERY 1, 10 (Aug. 2014), http://www.allenovery.com/publications/en-gb/fca-pra/Documents/the_new_landscape.PDF [hereinafter *FCA and PRA Senior Managers*].

88. Ahern et al., *supra* note 12.

89. Afghan, *supra* note 9, at 19.

90. *Id.*

91. Afghan, *supra* note 9, at 19.

92. *FCA and PRA Senior Managers*, *supra* note 87.

93. *Id.*

94. *See* MAYERBROWN, *supra* note 7 (stating that current Rules of Conduct require all other employees to report breaches annually); *but see FCA and PRA Senior Managers*, *supra* note 87 (stating that an early proposed version of the Rules of Conduct require breaches by all other employees must be reported quarterly).

95. Hitchins, *supra* note 11.

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

D. Comparisons to Compliance Management Systems

For U.S. financial firms, CMS is the analog of the SMCR.[100] While there may be similarities in the forms, CMS have been widely criticized for being overly vague.[101] For instance, the analog of the Senior Manager is the Compliance Officer, who is broadly charged with "develop[ing] compliance policies and procedures" and "ensur[ing] corrective action."[102] Along with designating Compliance Officers to carry out the regulatory scheme, firms "should generally establish a formal, written compliance program" which will reduce regulations and make auditing the firm's compliance protocols an easier process.[103] As for anything that could be considered an analog to the Conduct Rules, CMS leaves these rules up to the individual firms.[104] Analogs to the now-defunct reporting requirements are also left to the firm, though the FDIC suggests the Compliance Managers "monitor employee performance to ensure that they are following an institution's established internal compliance policies and procedures."[105] Firms are mandated to conduct an internal audit annually to detect compliance issues, which Compliance Managers should then act upon to remedy.[106]

III. ANALYSIS

While the extension of the SMCR may address some of the problems associated with the APR and generally promotes individual accountability to a far greater degree, there may still be serious problems with the SMCR. This Part looks at three specific—yet related—potential problems with the SMCR. First, the proposal for the SMCR put great emphasis on the fact that Senior Managers would be presumed to be responsible for any breach that occurs within their department, and thus would go a long way in promoting individual accountability and stable firms. After much outrage by the financial services market, this presumption has been removed.[107] The question remains as to whether the SMCR can be effective after the removal of what was initially heralded as a major provision of the regulations. Second, there is much uncertainty regarding the definition of "reasonableness," which is the enforcement mechanism that the SMCR relies on to determine the liability of Senior Managers in the event of breach. The degree to which "reasonableness" is defined largely answers the question of how effective the SMCR can be in achieving its goals, so giving some definition to "reasonableness" is paramount. Third, the reporting requirements served to force Senior Managers to report any actual or suspected breaches of the conduct rules, which was a serious step away from the front-

100. *See Compliance Management Systems*, *supra* note 10 (noting that a CMS requires board oversight of subordinate employees, a compliance program which provides training, monitoring, and consumer compliance response, and requires a yearly audit of these systems performed by the firm).

101. *See* Paul Martin, *Why It's Important to Have an Effective Compliance Management System in Place*, INT'L IN-HOUSE COUNS. J. (Aug. 2015), https://www.iicj.net/library/detail?key=875 ("Although these guidelines refer to a 'Compliance Management System (CMS),' they are vague as to what it should look like.").

102. *Compliance Management Systems*, *supra* note 10.

103. *Id.*

104. *See Compliance Management Systems*, *supra* note 10 ("Policies should be established that include goals and objectives and appropriate procedures for meeting those goals and objectives.").

105. *Id.*

106. *Id.*

107. *See* Part II.C. (noting that the presumption of responsibility was replaced by the "duty of responsibility" in response to outrage by the private sector).

loading problem of the APR. The removal of the reporting requirements may have a significant impact on what reasonableness means under the SMCR, and also whether the SMCR will face the same major front-loading problem of the APR.

A. Removing the Presumption of Responsibility: A Changing Ethos of the SMCR?

The removal of the presumption of wrongdoing on the part of a Senior Manager in the event of a breach may significantly weaken the effect of the SMCR. As has been discussed, one of the biggest impacts of the SMCR comes from the greater accountability of Senior Managers.[108] When the SMCR was originally proposed, a "reverse–burden of proof" was imposed on Senior Managers under the "presumption of responsibility," requiring them to prove that they took reasonable steps to prevent or mitigate a breach occurring or continuing to occur.[109] The reverse–burden has since been removed, and now the burden is on the regulators to prove that the Senior Manager was responsible for overseeing the activities in which the breach occurred and also that the Senior Manager did not take reasonable steps to avoid the breach from occurring or continuing.[110] This Section looks at whether the removal of the presumption of responsibility poses any real challenges to enforcing the SMCR, or rather if the removal of the presumption was simply a necessary change in form while the SMCR itself remains substantively unchanged.

In looking at the efficacy of the SMCR without the presumption of responsibility, it is important to look at the reasons why the presumption was removed. Most notably, in the effort to promote individual accountability among Senior Managers, the SMCR introduced the potential for criminal liability in the event of a breach which resulted in the failure of a bank.[111] While this step itself creates a large incentive for Senior Managers to prevent and mitigate breaches, criminal liability in tandem with the presumption of guilt conflicts with one of the bedrocks of English Law of innocence until proven guilty and raised potential human rights concerns.[112] Furthermore, the purpose behind forcing individual accountability is to prevent breaches and to ensure that customers are not harmed.[113] Many have argued that such a purpose conflicts with the likely effect of the presumption, which would cause a shift of qualified talent from the heavily penalized financial service industry

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108. *See* Debating Trust, *supra* note 67.

109. *See Senior Managers Regime*, *supra* note 14 (discussing the removal of the presumption of responsibility and its "reverse-burden of proof").

110. *Implementation Issues Arising from the Revised UK Senior Manager and Certification Regime*, SHEARMAN & STERLING LLP 3 (Nov. 2, 2015), http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/11/Implementation-Issues-Arising-from-the-Revised-UK-Senior-Manager-and-Certification-Regime-FIA-100215.pdf [hereinafter SHEARMAN & STERLING].

111. Jerome de Lavenere Lussan, *The Senior Managers Regime: The need for greater accountability throughout financial services*, AIMA (Dec. 18 2015), https://www.aima.org/article/the-senior-managers-regime—the-need-for-greater-accountability-throughout-financial-services.html .

112. *See id.* (noting that the presumption of responsibility "conflicted with the tradition under English law"); *Senior Managers Regime*, *supra* note 14 (noting that the presumption of responsibility created human rights concerns).

113. *CP15/22 Strengthening Accountability in Banking: Final Rules and Consultation on Extending the Certification Regime to Wholesale Market Activities*, FIN. CONDUCT AUTHORITY 1, 66 (July 2015), https://www.fca.org.uk/publication/consultation/cp15-22.pdf (noting that the SCMR advances the consumer protection).

in the UK into other industries or to firms overseas.[114] While the SMCR tries to ensure that financial service providers are actually providing beneficial services to customers, it would have had the inadvertent effect of reducing the quality of services that those firms were actually able to provide. Finally, somewhat in the same vein as the recruitment issues, many have argued that the presumption would over-regulate and distract service providers from focusing on providing quality services.[115] In essence, Senior Managers would be so focused on their *managerial* responsibilities in reducing potential liability that they would be far too risk-averse in their *substantive* responsibilities and would spend far too many resources on documenting decisions in intense detail so that they could meet the affirmative showing of reasonable steps that would be required under the presumption.[116]

In light of the arguments that the presumption would be counter-intuitive to the overall purpose of the SMCR, there are considerable reasons why the removal of the presumption may not pose a serious hindrance to effectively promoting individual accountability. Although the current burden may look a lot like one of the problems with the APR—making the regulator shoulder the burden of proving improper conduct after the violation has occurred makes it hard to effectively police violations—many argue that the change is more of a change in form than in substance.[117] The regulators themselves have stated that the original presumption of responsibility was not a "panacea" of the regulation, but was rather a small element of the SMCR and that they remain committed to enforcing individual accountability.[118] In essence, the SMCR as a whole and particularly its new clarification of duties provides a great degree of individual accountability.[119] Furthermore, the notion underlying an assessment of "reasonableness" still requires that senior managers implement, document, and can make an affirmative showing of their procedures.[120] Regulators will still scrutinize the decisions that senior managers have made leading up to and during a breach, and any obvious lack of action or deficiencies will be evident

114. *See generally* Lavenere Lussan, *supra* note 111.

115. *Id.*

116. *Id.*; *see also* Julian Bentley, *Four Key Issues with the Senior Managers Regime*, GTNEWS (Aug. 12, 2016), https://www.gtnews.com/articles/four-key-issues-with-the-senior-managers-regime/ (noting that the presumption of responsibility could make firms and individuals distinctly more risk averse).

117. *See* Sarah Isted, *The Removal of the Reverse Burden of Proof - a Cause for Celebration?*, PRICEWATERHOUSE COOPERS: FIN. SERV. RISK & REG. BLOG (Oct. 15, 2015), http://pwc.blogs.com/fsrr/2015/10/the-removal-of-the-reverse-burden-of-proof-a-cause-for-celebration.html (noting that the new burden still requires the same degree of reasonable care); Lavenere Lussan, *supra* note 111 ("Despite this reversal on the burden of proof, senior management will still be under the same stringent obligations to ensure that they have taken all reasonable steps to prevent a breach.").

118. *See Statement from the Financial Conduct Authority Following the Announcement by HM Treasury of Changes to the Senior Managers' Regime*, FIN. CONDUCT AUTHORITY (Oct. 15, 2015), https://www.fca.org.uk/news/statements/statement-financial-conduct-authority-following-announcement-hm-treasury-changes (quoting Tracey McDermott, acting chief executive of the Financial Conduct Authority) [hereinafter *Statement from Financial Conduct Authority*].

119. *See* Martin Wheatley, Chief Executive, Fin. Conduct Authority, Address at Bloomberg, Nothing to Fear from High Standards (Mar. 16, 2015), https://www.fca.org.uk/news/speeches/nothing-fear-high-standards (emphasizing the importance of the responsibilities map in the enforcement of individual accountability under the SMCR).

120. *See* Isted, *supra* note 117 ("[T]he hurdle that needs to be cleared remains at the same height, but now the regulators will need to demonstrate that the hurdle's been knocked over rather than the senior manager having to demonstrate that they've cleared it. The senior manager needs the same level of fitness and skill to clear it regardless.").

throughout the process.[121] The only real difference is that the regulator will have the burden of showing that action or inaction was unreasonable, based on alternative action that could have been taken, rather than the Senior Manager being required to expound upon why a particular action or inaction was reasonable given the circumstances.[122] Put another way, a showing of inaction by the senior manager will, in generally every circumstance, be unreasonable, so it is still in the senior manager's interest to implement and document proper procedures.[123]

B. SMCR as a Toothless Tiger: What is a "Reasonable Step"?

Although the removal of the presumption of responsibility in and of itself does not seem to create a meaningful obstacle in the way of the SMCR's effectiveness, there still remains uncertainty around how the SMCR will function in practice. Assessing the future efficacy of the extension of the SMCR is particularly difficult because of the uncertainty underlying the notion of reasonableness, which underlies the entire enforcement of the SMCR. This Section looks at the potential reasons why the existing guidance on reasonableness is inadequate, what reasonableness likely resembles in practice, and if there are any problems posed by the likely definition of reasonableness.

Reasonableness as a concept is typically hard to define in any abstract scenario, but this is particularly true under the SMCR, because it regulates a whole swath of very different firms of very different sizes. Because of the breadth of the type of firms that the SMCR covers, the existing examples given by the Prudential Regulation Authority as guidance on what reasonableness looks like in practice have been derided as inadequate because they are too fact-specific and are not numerous enough to give any real guidance.[124] It has even been suggested that to continue to provide advice tailored to particular scenarios would be irresponsible and increase confusion because even in the same industry, the differences between small and large firms make such advice inapplicable to one or the other.[125] Instead, firms are left to internalize the spirit of the SMCR and implement their own procedures which seem to accord with it.[126]

Current guidance from various experts has purported to shed some light on what reasonableness might look like in practice. Although they do provide guidance, most experts focus on the front-end portion of the SCMR in that their advice centers on providing more context on how to comply with the requirements of creating a responsibility map and statements of responsibility.[127] Although it is noted that after delegation occurs, it is of

121. *See id.* ("Senior managers will still have to comply with the senior manager conduct rules and therefore they still have to take reasonable steps to ensure that their part of the business is controlled effectively ").

122. *Id.*

123. *See* Lavenere Lussan, *supra* note 111 ("Determining [that reasonable steps were taken] will place heavy reliance on the quality of audit trails that are maintained to demonstrate that the relevant considerations and suitable due diligence took place.").

124. Bentley, *supra* note 116; *see also* Reynolds & Sahni, *supra* note 11 (arguing that additional guidance is necessary, especially in the form of regulators clarifying the type of actions that are not necessary in every case).

125. Bentley, *supra* note 116.

126. *Id.*

127. *See, e.g.*, David Biggin & Nicola Philbey, *Senior Managers Regime: are you taking reasonable steps?*, PA (Oct. 9, 2016), http://www.paconsulting.com/our-thinking/senior-manager-regime-are-you-taking-reasonable-steps/ (discussing primarily having controls for proper delegation of tasks in place, but discussing very

critical importance that proper governance of those employees occurs, there is not much advice on what exactly this means.[128] This is problematic because the SMCR is already quite specific on how an individual's duties are to be described and matched with an appropriate SMCR category.[129] What is lacking is the fact that continual oversight of employees is written into the SMCR, yet there is a dearth of information as to what this entails.[130]

In providing more context of "reasonableness," similar regulations and liability schemes may provide guidance. This is especially true considering the consistent approach the UK government has taken in determining reasonableness in similar contexts.[131] Some have suggested that Senior Managers can look to the Money Laundering Regulations 2007 for guidance on this issue, which imposes a similar liability on firms in the event that money laundering occurs.[132] Regulators of the Money Laundering Regulations have noted that they don't expect firms to prevent all instances of money laundering, and that firms can essentially discharge their statutory obligations by implementing procedures which purport to identify and mitigate the risk of money laundering.[133] This is also true of the Bribery Act 2010, which imposes similar liability, and also advocates a front-loaded approach of reasonableness, by suggesting that managers simply communicate their anti-bribery policies to their employees while also providing employees with anti-bribery training.[134] The Bribery Act 2010 is particularly noteworthy as a comparison, because the The Bribery Act 2010 has also been criticized for its excessive vagueness[135] that has created weak enforcement "rais[ing] serious doubts about the credibility of the government's commitment to the Bribery Act."[136]

As seen from the commentary by legal experts and the enforcement of similar statutes, what constitutes a Senior Manager's reasonable steps after delegation occurs is at best ethereal and at worst non-existent. This is problematic in two alternative ways. Senior Managers are either left with a serious responsibility that they have no idea how to carry out, or in the alternative, Senior Managers basically have no responsibility after delegation; essentially discharging their liability under the SMCR by implementing front-loaded approaches to prevent breach. The latter alternative is especially troublesome because it

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little as to continuing governance of employees); *The Senior Managers Regime: What it really takes to sleep soundly at night*, PRICEWATERHOUSE COOPERS (Apr. 2016), http://www.pwc.co.uk/assets/pdf/senior-managers-regime-apr16-v3.pdf (discussing that reasonable steps post delegation must be documented, but providing little insight into what reasonable steps actually are).

128. *See id.*

129. *See* Biggin & Philbey, *supra* note 127 (noting the specific requirements set forth that Senior Managers must comply with when delegating tasks).

130. *See supra* Part II.C (noting that Senior Managers are required to take "reasonable steps to ensure that the business of the firm for which they are responsible is controlled effectively.").

131. *See* SHEARMAN & STERLING, *supra* note 110 (noting that similar regulations allow firms to discharge their ongoing obligations by implementing certain preventative systems and controls).

132. *Id.*

133. *Id.*

134. *Id.*

135. *See* Monty Raphael, *A Defining Problem for the 2010 Bribery Act*, THE GUARDIAN (Feb. 2, 2011), https://www.theguardian.com/law/2011/feb/02/bribery-act-monty-raphael (noting that the uncertain definition of "corruption" created serious problems for the act).

136. David Leigh, *British Firms Face Bribery Blacklist, Warns Corruption Watchdog*, THE GUARDIAN (Jan. 31, 2011), https://www.theguardian.com/business/2011/jan/31/british-firms-face-bribery-blacklist (quoting Chandrashekhar Krishnan, executive director of Transparency International).

eschews the notion of continual responsibility of Senior Managers to diligently oversee their departments in preventing risks. In essence, the latter alternative suggests that complying with the Senior Manager's third obligation, to "take reasonable steps to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibility" does not actually require Senior Managers to "oversee the discharge of the delegated responsibility." More importantly, however, is that compliance with this third obligation seems to imply *per se* compliance with obligations one, two, and four of the Conduct Rules.[137]

C. Removing the Need to Report Suspect Breaches: Undermining the Conduct Rules and Proof that Reasonable Steps End at Delegation?

The UK government has recently removed the requirement for firms to report all breaches and suspected breaches of the Code of Conduct,[138] which appears to further muddy the question of what reasonableness is. As just discussed above, while reasonableness remains undefined, guidance from similar statutes likely suggests a weak, front-loaded approach that does not live up to the rigorous push for individual accountability which culminated in the SMCR.[139] This Section looks to give context to the removal of the reporting requirement in light of the removal of the presumption of responsibility and the uncertainty underlying the definition of "reasonable steps".

It is necessary to understand the justifications behind the removal of the reporting requirement when looking at its implications. The government has stated that the reporting requirement could potentially be very costly for firms.[140] Specifically, the government points out that large firms that employ large numbers of staff would have to put detailed systems and controls in place to ensure compliance.[141] The problems with this explanation are numerous. Not only are large firms more equipped to be able to handle these costs, but breaches are much more likely to happen, go unnoticed, and have perverse consequences on the market at large.[142] Most importantly, the government provides no justification for why the costs outweigh the utility of the reporting requirement.[143] This is especially troublesome given the fact that "[a]ll of the individuals within the . . . Certification Regime . . . are by definition capable of causing significant harm to a firm."[144] Despite the government declaration that the reporting requirement is too costly, that the government has left the option open for the relevant agencies regulating under the SMCR to implement their own rules to ensure that they are notified of breaches, though there is no requirement

137. *See* Part II.C. (discussing the four specific Conduct Rules for Senior Managers).

138. *Supra* Part II.C.

139. *Supra* Part III.B.

140. HM Treasury, *supra* note 15 , at 12.

141. *Id.*

142. CHANGING BANKING FOR GOOD, *supra* note 2.

143. The acting chief executive of the FCA has simply stated that the Conduct Rules "provide clear incentives for individuals to maintain appropriate standards of behavior in their dealings with customers and their activities in the UK market." Rozi Jones, *FCA rule changes remove need for firms to report breaches*, FIN. REP. (Jan. 6, 2016), http://www.financialreporter.co.uk/finance-news/fca-rule-changes-remove-need-for-firms-to-report-breaches.html.

144. *Strengthening Individual Accountability In Banking: Responses to CP14/14, CP28/14 and CP7/15*, BANK OF ENG. PRUDENTIAL REG. AUTHORITY 10 (July 2015), http://www.bankofengland.co.uk/pra/Documents/publications/ps/2015/ps1615.pdf [hereinafter PRUDENTIAL REG. AUTHORITY].

that they do so.[145]

The removal of the reporting requirement undermines the ability to enforce the conduct rules. As noted before, the conduct rules provided the only "teeth" of the act for employees covered under the act who are not senior managers, and the reporting requirement ensured that breaching employees were held accountable.[146] The conduct rules that apply to non-senior managers are, by their nature, preventative; they are really baseline ethical standards designed to prevent actual harm to the firm and its customers.[147] These rules are essentially impossible to enforce prior to actual misconduct without the firm reporting to the regulator.[148] For instance, Rule 1 requires employees to act with integrity; but without an actual investigation into some other harm, there is no way for the regulator to know that an individual employee within a large firm has not acted with integrity at some point. This means that Conduct Rules will not be prospective and looking to prevent harm, but will simply be retrospective, imposing penalties after harm has occurred.

Given the importance of the Conduct Rules to the SCMR as a whole, removing the reporting requirement reinforces the notion that a Senior Manager's "reasonable steps" likely end after delegating tasks in compliance with the third Senior Manager Conduct Rule. As was previously mentioned, the SMCR is quite clear on how tasks are to be mapped out and delegated, yet it is unclear on the Senior Manager's continuing duty of oversight.[149] The one clear responsibility that a Senior Manager did have post-delegation of duties was to report suspected and actual breaches of the Conduct Rules within seven days.[150] Though the timeframe of seven days to report may arguably be too burdensome on Senior Managers,[151] reporting suspected or actual breaches of the Conduct Rules in general would seem to fall squarely within the definition of a "reasonable step" towards preventing or mitigating an actual breach.[152] If a Senior Manager is not required to notify the relevant regulator that a breach is likely to occur or has occurred, it is difficult to see what continuing duty the Senior Manager has. This has particular ramifications for the fourth Senior Management Conduct Rule, which is to "disclose appropriately any information of which the FCA or PRA would reasonably expect notice".[153] If the Government has already stated that reporting any actual or suspected breaches is too costly to require, then how can any regulatory agency "reasonably expect" to be notified of them?

IV. RECOMMENDATION

The efficacy of the SMCR depends largely upon the definition of a Senior Manager's

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145. SHEARMAN & STERLING, *supra* note 110, at 4.

146. *Supra* Part II.C.

147. *See* MAYERBROWN, *supra* note 7, at 2 (noting that the conduct rules "focus on the concepts of acting with integrity, skill, care and diligence").

148. *See Statement from Financial Conduct Authority*, *supra* note 118 (noting that the Conduct Rules are meant to be first enforced by the firm itself, but in a system where the regulator takes enforcement action if necessary).

149. *See generally supra* Part II.C.

150. MAYERBROWN, *supra* note 7.

151. *See* PRUDENTIAL REG. AUTH., *supra* note 144, at 10 (noting that many firms were concerned that seven business days was not sufficient time to properly investigate a potential breach).

152. CHANGING BANKING FOR GOOD, *supra* note 2, ¶ 634.

153. *See* Afghan, *supra* note 9, at 19 (discussing the four specific Conduct Rules for Senior Managers).

duty to take reasonable steps to prevent or mitigate breaches. While "reasonable steps" have always tended to be somewhat amorphous, the removal of the presumption of responsibility in tandem with the removal of reporting requirements suggests a weak and front-loaded approach to "reasonable steps." To provide a strengthened definition of a Senior Manager's duty to take reasonable steps, this Part recommends that the UK government reinstate the presumption of responsibility.

This part also recommends specific courses of action for firms regulated in the United States based on the benefits created by the SMCR and the detriments created by removing the presumption of responsibility and reporting requirements. Ultimately, this recommends that these firms implement the SMR, as well as their own forms of the presumption of responsibility and reporting requirements.

A. Recommendation for the UK Government: Reinstate the Presumption of Responsibility

Reinstating the presumption of responsibility will increase the efficacy of the SMCR in general, and allow the government to delegate specific rulemaking more easily. The benefit that the presumption of responsibility provides is a strengthened definition to the "reasonableness" criteria by resolving any ambiguities that Senior Managers may face under the SMCR in favor of taking affirmative action to remedy or prevent breaches, resulting in increased consumer protection. Although the presumption may not have been a "panacea" of the SMCR, reasonableness is fundamental to the SMCR, which the presumption helps to shape. Critics of the presumption of responsibility have suggested that its removal will not change the fact that Senior Managers will still be required to make a showing to regulators that their conduct was reasonable, and thus no real change in substance will occur.[154] The industry response of outrage to the presumption of responsibility suggests that, even if the critics' assertion were true, the industry obviously views the presumption as a substantive difference and will increase their own enforcement of the SMCR requirements in response.[155] This highlights a primary reason why the presumption of responsibility is important. This industry perception is supported by the fact that the presumption of responsibility creates real incentives to enforce the SMCR more diligently.[156]

Although the industry perception of the presumption of responsibility as a very real requirement to act diligently shows why it is important, the benefit provided by the presumption of responsibility in the context of the removal of the reporting requirements highlights its importance. The presumption of responsibility would counteract the effect of the removal of the reporting requirements and serve as a specific example of the presumption's substantive added value. As previously noted, it is especially difficult to understand what the continuing duty of Senior Managers is post-delegation since the removal of the reporting requirements.[157] However, while there is no *per se* duty to report

154. *See supra* Part III.C. (noting the argument that the presumption of responsibility did not add anything beneficial, because firms still have to produce a record of reasonable steps regardless).

155. *See supra* Part II.C. (discussing that the presumption of responsibility was abandoned after the industry expressed outrage at its inclusion).

156. *See supra* Part IV.A. (discussing the different behaviors of a Senior Manager not subject to the presumption of responsibility and a Senior Manager who is subject to the presumption of responsibility).

157. *See supra* Part III.C. (questioning what the continuing duty of a Senior Manager is post-delegation after the removal of the presumption of responsibility).

breaches or suspected breaches, a Senior Manager still has the duty to ensure that the business of the firm for which they are responsible is controlled effectively and appropriately discloses any information of which the FCA or PRA would reasonably expect notice.[158] Again, the response from the industry to the presumption of responsibility already suggests that they would be heavily inclined to report breaches of the conduct rules to regulators, but an example may help further highlight why. Posit that the conduct rules were breached by an employee who is subject to them but is not in the Certification Regime, and that this breach is one small step that turns into serious misconduct on the part of the firm, resulting in an investigation by a regulator. Whether the presumption is in place or not, continually reporting conduct breaches from non-Certification Regime employees is likely to be arduous and costly in the aggregate, and in most cases it is going to be extremely difficult for the regulator to find out that the initial breach has occurred unless the breach is reported to it. A Senior Manager not subject to the presumption likely will not report these types of breaches, because they get no benefit from doing so. If the regulator will not find out about the breach, and the regulator has the burden of proving lack of reasonable steps, there is no point in informing them. A Senior Manager that is subject to the presumption of responsibility *will* report the breach. This Senior Manager knows that she has to affirmatively prove that she took reasonable steps in the event of any investigation by a regulator. Reporting these types of initial breaches is affirmative proof of reasonable steps taken by the Senior Manager, and thus it is *beneficial* for her to report them. Thus, even in the absence of the reporting requirement, Senior Managers will still likely report breaches and essentially uphold the reporting requirement because of the presumption of responsibility.

Reinstating the presumption is also a simple way for the government to retain significant control over the SMCR while delegating more specific rulemaking to regulators. By reinstating it, the government sets a benchmark for the act as a whole of strong enforcement, and thus any rulemaking that regulators engage in is set in the shadow of heavy enforcement, limiting the effect of rulemaking to a certain degree. This limitation on regulators' rulemaking power would enable the government to delegate more of the rulemaking process to regulators. It would allow regulators to do much more rulemaking and narrowly tailor the enforcement of the SMCR to their respective industries in a way that would maximize the effect of the regulation in the industry. At the same time, the government could maintain confidence that if the resulting rules do end up lacking in some way, firms will still try to comply with the spirit of the SMCR because of the presumption of responsibility.[159]

B. Takeaways for Financial Service Providers Regulated in the United States

For those financial service providers in the U.S. which are also required to operate as mini-regulators through a CMS, implementation of many of the SMCR requirements may prove fruitful. Companies looking to implement a CMS are tasked with vague requirements and harsh penalties for improper implementation.[160] Fortunately, the SMCR is essentially

158. *See supra* Part II.C. (noting the four conduct rules specific to Senior Managers).

159. *See supra* Part IV.A. (discussing the different behaviors of a Senior Manager not subject to the presumption of responsibility and a Senior Manager who is subject to the presumption of responsibility).

160. *See* Piotr Kaminski & Kate Robu, *A best-practice model for bank compliance*, MCKINSEY & COMPANY

a much more specific version of the CMS regime in certain respects. In particular, Compliance Managers would be advised to implement the procedures laid out in the SMR regime, as these requirements provide specific guidelines on compliance procedures, training procedures, and systems for monitoring subordinate employees. Implementation of the responsibilities would also be advised. Because this particular mechanism is the chief oversight method prescribed in the SMCR, it would guide Compliance Managers in establishing protocols that are designed to detect and remedy breaches after they occur. It would also go a long way towards the suggestion that firms establish a formal, written compliance program.

For firms struggling with the "compliance" and "audit" functions, the SMCR does not provide the most useful guidance now that the UK government has removed a chief compliance mechanism in the presumption of responsibility, and a chief auditing function in the reporting requirements. However, the wisdom of the presumption of responsibility is still apparent and firms looking to avoid the rising costs of noncompliance are free to implement their own version of the presumption. Firms may choose to hold managers accountable if their respective department breaches regulatory rules through a variety of institutional measures, such as suspension or fines, in the absence of a compelling justification given by the manager. As previously discussed, implementing such a system will likely reinforce much of the reporting functions built into the "auditing" function. However, firms should still institutionalize formalized reporting requirements. Reporting conduct breaches is essential to individual accountability and preventing further breaches of regulatory rules.

V. Conclusion

The UK government should reinstate the presumption of responsibility for Senior Managers under the SMCR. Firms regulated in the United States should also consider implementing the SMR wholesale, as well as implementing their own versions of the presumption of responsibility and reporting requirements.

(Jan., 2016), http://www.mckinsey.com/business-functions/risk/our-insights/a-best-practice-model-for-bank-compliance (noting that "[c]ompliance risk has become one of the most significant ongoing concerns for financial-institution executives" because of the expanding scope of regulatory focus and dramatically increasing regulatory fees, which necessitates a structural answer for the industry).