

February 2019

## Heads of Legal not required to be Senior Managers

### Summary

Firms, in-house lawyers and the legal profession generally will be relieved that the Financial Conduct Authority ("**FCA**") has decided to *exclude* firms' Heads of Legal from the requirement to be approved as a Senior Manager under the Senior Managers Regime ("**SMR**").

The FCA concluded that because so much of a Head of Legal's work relates to legal advice, the laws of legal professional privilege ("**privilege**") would likely restrict the FCA, in practice, from using its powers over Senior Managers. The benefits that normally result from applying the SMR will be substantially reduced so that any remaining benefits are not sufficient to justify applying it. However, Heads of Legal will continue to have to be certified by firms under the Certification Regime and be subject to the Individual Conduct Rules.

### Background

The FCA has published Consultation Paper CP 19/4 in which it sets out its response and proposals following feedback it received to Discussion Paper DP 16/4. In particular, it clarifies its views as to whether or not a firm's Head of Legal should be approved as a Senior Manager under the SMR.

The SMR represents a fundamental shift in the way that the FCA holds individuals working in the financial services sector to account. The rules, which have applied to banks and PRA-designated investment firms since March 2016 and which will apply to all firms from December 2019, aim to enhance and embed a culture of individual responsibility and accountability within firms.

A core principle of the SMR is to ensure that every part of a firm's business or activities has a Senior

Manager with overall responsibility for it<sup>1</sup>. This Senior Manager must be pre-approved by the regulators, will be subject to the Senior Manager Conduct Rules and will have a duty of responsibility for the management of their function.

Senior Managers are designated a Senior Management Function ("**SMF**"), of which there are 30, that broadly correspond to that part of the business that they are responsible for<sup>2</sup>. However, there is no specific SMF for the role of Head of Legal.

Prior to publication of CP 19/4, the FCA confirmed that although the legal function was not included in its indicative list of business activities and functions, responsibility for the management of the legal function should be included in the SMR<sup>3</sup>. Whoever had overall responsibility for management of the legal function, and was not covered by another specific SMF in the firm, needed to be captured as an SMF 18 (the 'Other Overall Responsibility Function'). SMF 18 allows a firm to allocate overall responsibility for an activity, business area or management function to someone whose job is not otherwise included in the list of SMFs.

However, the FCA said that any firm that sought to make a decision in good faith about whether or not an individual in charge of their legal function required approval, on the basis of the published rules and the FCA's communications, should not need to change their approach in the interim. The FCA's approach, which lacked clarity and raised concerns about what looked like an attempt to undermine

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<sup>1</sup> SYSC 4.7.8R provides that "A firm must ensure that, at all times, one or more of its SMF managers have overall responsibility for each of the activities, business areas and management functions of the firm".

<sup>2</sup> This figure is inclusive of SMFs that apply solely to insurers.

<sup>3</sup> <https://www.fca.org.uk/news/statements/clarifying-our-supervisory-intentions-overall-responsibility-legal-function-under>

privilege, was roundly criticised. The FCA said that it would consult on the issue.

### Particular concerns with requiring the Head of Legal to be an SME

Responding to DP 16/4, firms and the legal profession generally raised serious concerns about the inclusion of the legal function as an SMF. Principal among those concerns was the threat that this posed to the potential erosion of privilege and the legal function's independence.

#### Erosion of privilege

Respondents argued that the duty of responsibility, which all Senior Managers must comply with, would put firms under pressure to waive privilege to allow the Senior Manager performing the Head of Legal role to demonstrate that they had taken reasonable steps to discharge that duty. Respondents argued that this would create a potentially significant conflict of interest. Specifically, the Senior Manager may want, or need, to rely on privileged material to demonstrate reasonable steps, but at the same time be obliged to advise the firm, whose privilege it was, not to waive privilege for other reasons.

In its response to DP 16/4, the Law Society noted that "[c]lients need to be able to consult with lawyers safe in the knowledge that the instructions they give and the advice they receive will not be used to incriminate them later on in the process"<sup>4</sup>.

#### Loss of independence of the legal function

Respondents also argued that including the legal function as a Senior Manager would undermine the independence of the function. They set out two principal concerns.

- First, personal liability may affect lawyers' judgement, making legal teams more conservative and less likely to pro-actively offer advice. This may also cause them to avoid asking necessary questions or investigating matters if information that comes to light increases their personal exposure as a Senior Manager.
- Secondly, under Senior Manager Conduct Rule 4, Senior Managers are required to notify the FCA of anything of which it would reasonably require notice. This could create a conflict with the duty of confidentiality and the Solicitors Regulatory Authority Principle 4 obligation to act in the best interests of the client.

### The FCA's proposals and guidance

Having considered the responses to DP 16/4, the FCA has confirmed that the Head of Legal will be excluded from the requirement to be approved as a Senior Manager. Requiring Heads of Legal to be approved as Senior Managers risked the provision of full and frank legal advice to firms; and privilege would restrict the FCA from using its powers over Senior Managers, including its usual supervisory processes. The benefits that normally result from applying the SMR will be substantially reduced so that any remaining benefits are not sufficient to justify applying it.

However, Heads of Legal are not excluded from the SMR as it applies more broadly. The Head of Legal is included within the Certification Regime, meaning a firm must certify annually that the individual carrying out the role of Head of Legal, among other things, meets the FCA's 'fit and proper' persons test; and they must comply with the Individual Conduct Rules. This will deliver most of the benefits as requiring these individuals to be pre-approved as Senior Managers, without compromising privilege.

#### Guidance

The FCA provided further guidance when considering the application of the SMR to lawyers who are responsible for part of a firm's business activities or management functions, other than or in addition to the legal function.

- In excluding the Head of Legal from the SMR the FCA is not proposing to exclude anyone who is a lawyer from performing a SMF. There may be cases where the Head of Legal performs another SMF, for example; the Chief Operations Officer or Head of Compliance. In such cases, they will be required to be pre-approved as the appropriate SMF.
- In these instances, the Head of Legal will still have responsibility as a Senior Manager for their additional role. Firms will be expected to clearly outline the responsibilities for each role in the individual's Statement of Responsibilities.
- The FCA does not see its proposal to exclude the Head of Legal from the requirement to be approved as a Senior Manager as creating an opportunity for firms or Senior Managers responsible for other business areas or functions to avoid their responsibilities.
- Senior Managers are required by Senior Manager Conduct Rule 2 ("**SC2**") to take reasonable steps to ensure that the business of their firm for which they are responsible complies with the relevant

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<sup>4</sup> [file:///C:/Users/IRVINA/Downloads/overall-responsibility-legal-function-response%20\(2\).pdf](file:///C:/Users/IRVINA/Downloads/overall-responsibility-legal-function-response%20(2).pdf)

requirements and standards of the regulatory system. This includes the obligations imposed on firms by Principle 11 and SUP 15 to notify and/or disclose to the FCA.

- Senior Managers must, to comply with SC2, take reasonable steps to ensure that all employees, officers, agents and contractors working within or retained by the businesses of the firm for which those Senior Managers are responsible, and who become aware of a matter subject to those obligations, report the matter without delay so that it is disclosed promptly to the FCA. They must do so even if the matter is, in parallel, the subject of or referred to or described in legally privileged communications, documents or other records created within or for the firm.

## Conclusion

The FCA's decision to exclude the Head of Legal from the SMR, acknowledging the fundamental importance of privilege, will be welcomed by firms, in-house lawyers and the legal profession generally. Although not required to be pre-approved as Senior Managers, Heads of Legal will require to be certified by firms and comply with the Individual Conduct Rules. Firms should note the guidance issued by the FCA where a qualified lawyer is responsible for an area of a firm's business activities or management function other than or in addition to the legal function and the requirement for that person to be pre-approved as the appropriate SMF in such cases.

## Key contacts



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