

9 January 2017

Ms. Sophie Stern  
Governance and Professionalism Policy  
Strategy & Competition Division  
Financial Conduct Authority  
25 North Colonnade  
Canary Wharf  
London E14 5HS

Dear Ms. Stern:

The Association of Corporate Counsel (ACC) appreciates the opportunity to comment on the overall responsibility of the legal function in the Senior Managers Regime (SMR). ACC is a global bar association that promotes the professional and business interests of in-house counsel, with over 40,000 members employed by over 10,000 organizations in more than 75 countries. ACC has more than 2,200 members throughout Europe, including 638 in the United Kingdom. More than 6,800 of our members are the heads of legal departments.

ACC does not think that the head of the legal function of regulated firms should be included in the SMR. We think doing so would weaken legal departments and have a negative effect on the relationship between in-house counsel and their business-colleague clients. We disagree with many of the justifications for inclusion of the legal function in the SMR the Financial Conduct Authority (FCA) has elaborated on in its discussion paper (DP16/4). Finally, we are also concerned by the international consequences of including the legal function in the SMR. While we have not identified separate answers to Question One and Question Two of the FCA discussion paper, we feel our comments below fully answer both questions.

**Including the head of the legal function in the SMR would have undesirable effects on the attorney-client relationship**

In-house counsel have a strong interest in the regulatory compliance of banks and financial institutions. As the professionals who defend their firms against regulatory enforcement actions and all the related legal consequences, in-house counsel have long been supporters of corporate compliance efforts that prevent violations before they occur. However, including in-house counsel themselves in these regulatory regimes is often counterproductive because it weakens the in-house legal function. The in-house legal department can play an important preventative role in avoiding risks and liabilities. It is most effective when in-house lawyers feel unrestrained in their ability to speak freely and offer legal advice to their business-colleague clients. The inclusion of the head of the

legal function in the SMR threatens this free exchange because (1) it would impose a duty of disclosure on the general counsel/head of legal, which would make employees less likely to seek legal advice, not only to the general counsel/head of legal, but to any in-house counsel that reports into the head of the legal function; and (2) the legal department's own awareness of being subject to the SMR may affect attorneys' judgment in providing legal advice, making them overly reluctant for fear of subjecting the firm or themselves to liability.

If the legal function were included in the SMR, the head of legal would be subject to Senior Manager Conduct Rule Four: "You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice." The FCA has not stated how this conduct rule would apply to a general counsel, but if it were to apply as currently written, the results to in-house legal departments would be disastrous. Usually, senior managers can come to the general counsel, disclose some troubling legal or ethical issue going on in their division and receive advice from the general counsel on how to address the issue. If the general counsel has a duty to disclose to the FCA under this rule, senior managers will be significantly less likely to bring matters to the attention of the general counsel, for fear that the general counsel might feel the information is something that he or she must disclose. The result is that legal advice is sought less frequently, which is not a positive result for increasing regulatory compliance and reducing risks. The same applies in connection with business managers going to other in-house counsels that report into the head of the legal function.

This reporting duty may also have a significant impact on the firm's right to exercise its legal professional privilege relative to advice received from the general counsel and others in the legal department, because if the general counsel is required to disclose these matters to the FCA, then the privilege might be waived. The FCA states in its discussion paper that the SMR does not vitiate privilege, but including the legal function in a regulatory scheme that includes a reporting duty sends a different message to stakeholders. In-house counsel find great value in knowing their communications of legal advice to their business-colleague clients are privileged. A recent ACC survey found that 66 percent of in-house counsel felt that their firms' compliance efforts would be negatively impacted if their communications with employees were not protected by legal professional privilege. This is because individuals are more forthright in seeking legal advice when they believe their communications are protected and confidential. This is why privilege is important to the maintenance of effective compliance and legal advice systems, and the FCA should be very reluctant to create even the suggestion that privilege would be threatened by the SMR regime. We further address some of the FCA's discussion paper assertions about legal professional privilege below.

The second way the inclusion of the head of the legal function in the SMR would affect the attorney-client relationship is the specter of the lawyer's personal liability stemming from the legal advice provided. While the reporting duty found in the Senior Manager Conduct Rules would only apply to the general counsel/head of legal, all in-house counsel would feel the overall hierarchical, functional and psychological effect of including the legal function in the SMR. In section 3.24 of the discussion paper, the FCA

states that “the focus of the SMR is not on the provision of legal advice but on the effective management of the function.” But the question of whether or not the legal function is effectively managed would likely only arise due to some question about the quality of legal advice provided. A lawyer’s concerns about personal liability can affect his or her judgment, and make the lawyer less likely to proactively offer legal advice. Additionally, lawyers who are viewed by their business-colleague clients as overly conservative due to fear of personal liability will be less likely to be consulted by those clients on difficult issues. In this manner, the SMR would create an overall climate of inhibition of legal advice. Of course, lawyers should not be immune from enforcement actions simply because they are lawyers. But they also should not be liable for reasonable advice given in good faith that in hindsight turns out to be wrong. Including the legal function in the SMR regime certainly raises the concern that lawyers will be held liable for their advice.

### **Many of the FCA’s arguments in favor of including the legal function in the SMR are flawed**

We disagree with many of the FCA arguments for inclusion of the head of the legal function in the SMR. Our primary point of disagreement is that the legal function is not a management or business function similar to the other Senior Management Functions, and therefore does not fit well into the architecture of this regime. In section 3.21 of the consultation paper, the FCA states that it is “the management of the function and not the provision of legal advice that brings” it into the SMR; however, as we note above, it would be difficult to separate an evaluation of the manager of the legal function without also evaluating the quality of legal advice provided. The “business” of the legal function is primarily to provide advice to the business units and manage various transactions and legal proceedings involving the firm. The FCA argues that the legal function should be included in the SMR because systemic failings in the legal department can create risks that impact the business of the firm. In section 3.23 of the discussion paper, the FCA states that concerns about training, processes or resource management are distinct from the quality and accuracy of legal advice. However, the only way poor management of the legal function creates a risk is that it enables poor legal advice. We disagree with the FCA’s assessment that it is possible to adequately separate the management of the legal function from the quality of the legal advice provided.

Once you divorce the management of the legal function from the provision of legal advice, the SMR regime makes little sense in the context of the legal function. Looking at the conduct rules applicable to senior managers, one can see how the legal function does not quite fit. For example, conduct rule two requires senior managers to take reasonable steps to ensure “that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.” What does this mean in the context of the legal function? How would the FCA determine whether a general counsel has met this requirement when there are no FCA regulatory requirements and standards that apply to the management of the legal function? This is in stark contrast to the other senior management functions that are included in the SMR, where there are very specific mandates the FCA expects to be met by the employees working in these

functions. To the extent that the FCA does seek to oversee the provision of legal advice, we would suggest that there would be little regulatory benefit to including the legal function in the SMR. Moreover, such oversight would still suffer the risk of inhibiting the provision of legal advice, as discussed above.

We also disagree with the FCA's position on legal professional privilege as expressed in the arguments for inclusion of the legal function. While we concede that it would be difficult for the FCA to bring an enforcement action against a general counsel/head of legal based on privileged information, that is not the concern. The concern is that the FCA would bring an enforcement action against a general counsel/head of legal and the materials that would best defend the general counsel's actions or advice consist of materials that are privileged – a privilege that is held by the company. This sort of conflict of interest between the general counsel's right to defend against charges and the company's right to maintain privilege is something that is unique to the general counsel/head of legal. Contrary to the FCA's argument in section 3.32, other employees do not have the same conflict because they do not have an ethical duty to keep the company's confidences. Only a lawyer has the ethical duty not to disclose the company's confidences and can be disciplined for doing so.

Our last point of disagreement with the FCA's arguments for inclusion of the legal function is with respect to the ability of firms to appoint a non-lawyer senior manager as the head of the legal function. In the vast majority of firms, identifying anyone other than the general counsel or chief legal officer as the senior manager of the legal function would create an artifice just for the sake of SMR compliance. It is a small minority of companies (if any) in which the legal function is not headed by a lawyer. Creating a regulatory system that encourages having the legal function "embedded" in another department would only weaken the effectiveness of the in-house legal department, resulting in greater risks of noncompliance with regulatory standards. This is because in-house counsel would be wary of approaching a non-lawyer supervisor with legal problems because such disclosure may waive the client's privilege as well as put the supervisor at risk of personal liability for the problems.

### **If the FCA includes the head of the legal function in the SMR, it should consider the international ramifications**

ACC is concerned about the potential international consequences of including the head of the legal function in the SMR. If general counsel/head of legal of UK subsidiaries or branches of foreign banks and firms are included in the regime, then the negative effects of the regime as discussed above are amplified by the firm's international presence. For example, in-house counsel at a bank headquarters in Canada may be reluctant to consult with in-house counsel in the UK because of the knowledge that the UK legal function is supervised by the FCA. The UK has a strong reputation of protecting the independence of its lawyers and the legal privilege of its clients. The SMR's negative impact on that reputation would have international business consequences, inhibiting the provision of legal advice across international borders within those affected firms.

We understand there are dual regulation concerns for solicitors who would come under the SMR, as they are already subject to regulation by the Solicitors Regulation Authority (SRA). Some of the requirements of conduct under SRA rules, like maintaining independent judgment and client confidentiality, and remaining free of conflicts of interest could directly conflict with the SMR conduct rules and result in disciplinary actions against solicitors subject to the SMR. In considering this issue, the FCA should take into account that these dual regulation concerns would also exist for in-house counsel regulated by non-UK bodies. Across common law and civil law jurisdictions, in-house counsel are often subject to codes of conduct from their licensing bodies that require independent judgment, maintenance of client confidentiality, and remaining free of conflicts of interest. There can also be additional applicable codes of conduct requiring similar principles. For example, European lawyers may also be subject to the Council of Bars and Law Societies of Europe's (CCBE) code of conduct. If lawyers who are already regulated by legal professional bodies are also subject to SMR conduct rules, they will be put in the difficult position of serving two masters with conflicting rules.

The other international consideration for the FCA is whether UK branches and subsidiaries of foreign banks that have no UK-based legal department will be expected to designate a non-UK professional as senior manager of the legal function. We understand that branches/subsidiaries are expected to identify non-UK personnel for some of the other senior management functions when those functions are managed by someone outside of the UK. When it comes to firms with an international footprint, there are myriad ways to structure the legal department. The legal department responsible for providing advice to the UK branch of a foreign bank may be located at the foreign bank's headquarters. Indeed, many global legal departments sit primarily within the firm's headquarters. Take for example a small UK branch of a US bank. In this case, the individual with primary responsibility for legal services to the UK branch may be a senior attorney sitting in the US who is not the head of the US legal department. Therefore, there is no "management" of the legal function carried out by this individual – they are simply the lawyer who is responsible for advising that particular branch of the firm. In this example, including the US attorney as an SMR would seem to produce none of the benefits the FCA is after, but all of the negative effects detailed above. The FCA should carefully consider whether such arrangements should be captured by the SMR.

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The strength of the relationship between business clients and in-house counsel may seem of no import to a regulator. But our members know the important risk-management role that in-house counsel play in modern business and how important client trust and confidence are in being able to play that role. Including the legal function in the SMR erodes that trust between client and attorney and provides little regulatory benefit to the FCA. We strongly urge the FCA to omit the legal function from the SMR.

Sincerely,



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