Senior Managers & Certification Regime:

A Call for Evidence from HM Treasury

https://www.gov.uk/government/consultations/senior-managers-certification-regime-a-call-for-evidence

Response by the Transparency Task Force, 1st June 2023

This response is all non-confidential.

Question 1: Has the SM&CR effectively delivered against its core objectives? For example, making it easier to hold individuals to account; or improving governance, behaviour and culture within firms

No. Primarily because the regime has not been implemented with sufficient vigour by the regulators. The failure is not a function of insufficient powers but the absence of means of holding to account regulators for being reluctant to use them to full effect. Public perception is that there is little or no protection from consumer harm as a result of firms being authorised and regulated by the FCA. SM&CR should be a major part of consumer protection but there is a complete lack of visibility. Improving governance, behaviour and culture within firms is directly related to the deterrence effect of sanctioning poor examples. Success here is achievable with a sufficiently active regulator.

Question 2: Do these core objectives remain the right aims for the UK?

As stated in 2.9 *The primary objectives of the SM&CR, as a whole, are to reduce harm to consumers and strengthen market integrity*. These objectives are of course FSMA 2000 objectives, The regulator has a duty to advance those objectives including utilising its powers under SM&CR. There can be no question that these aims (or more properly duties) should be achieved. The regulator is in theory accountable to parliament for ensuring appropriate metrics are satisfied, but the absence of an evidential trail of it being called to

account for failure to achieve a material number of sanctions under SM&CR suggests that additional measures are required.

Transparency Task Force has previously advocated three measures that would remedy this shortfall:

- The introduction of a statutory oversight body to ensure that the FCA does a good job for consumers (https://drive.google.com/file/d/1cWFPqo_woF8b4V5wlqr2iDgIb_j4_7hi/view?usp=share_link)
- The creation of an actionable duty of care owed by authorised persons to consumers. Note that The Financial Services Act 2021 required the FCA to consult on the introduction of a Duty of Care (https://www.legislation.gov.uk/ukpga/2021/22/section/29/enacted) but the consultation has not yet been carried out and consequently a Duty of Care has not yet been implemented. Such a Duty would empower consumers to sue both firms and senior managers for causing them foreseeable harm that result in financial loss. The result would be to allow citizens to seek remedies where regulators fail to do so, providing a powerful political incentive for regulators to be more proactive, by showing up any regulatory complacency or capture;
- The removal of the regulators' exemption from civil liability and revisions to the Complaints Scheme to require it to provide remedies for financial loss caused by regulatory failure and make the Complaints Commissioner's findings binding instead of advisory. This would create financial jeopardy for regulators that become aware of wrongdoing by individuals or firms and fail to enforce against them, thereby leaving other consumers at risk. It would therefore provide a compelling economic incentive for regulators to become more assertive

Question 3: Has the regime remained true to its original objectives or has the scope or use of the regime shifted over time?

These are two different questions. First, the stated objectives patently have not changed. Second, clearly the scope of the regime has changed.

Question 4: The government would be interested in respondents' reflections on their experience of the SM&CR, now that it has been in place for some years.

From a consumer perspective SM&CR has had no visible impact despite it being in place for some years. There are numerous examples of where it should have been utilised but wasn't. One wonders which proportion of the violations by the financial sector shown here *should* have had an SM&CR dimension to the regulatory response, as opposed to simply imposing fines on the innocent shareholders of the organisations concerned.

Of course the answer is virtually (or arguably literally) none.

Why is that, when it is so obvious that personal accountability is a key driver for good conduct. A woeful lack of jeopardy for the individuals responsible for malpractice, malfeasance, misconduct and mis-selling is close to condoning the behaviour, which is not that far removed from inviting it.

Question 5: What impact does the SM&CR have on the UK's international competitiveness? Are there options for reform that could improve the UK's competitiveness?

The government has been lobbied hard by the financial services sector, led by UK Finance and other financial services groups that the standards and requirements under SM&CR are over onerous and act as an impediment to new entrants establishing businesses in the UK. But in reality of course, the UK is very much open for business for those who are prepared to accommodate the standards of good conduct that are required. The impressive range of international financial firms that have a UK base and accept the importance of those standards bears testament to the fact that it is a spurious argument to suggest SM&CR, which has been in place for some years, has any anti-competitive effect. Rather it is commonly a wish that individuals in positions of responsibility would prefer to have less accountability.

A competitive regulatory environment is one in which firms wish to domicile because they want access to a large and affluent domestic marketplace and because firms regulated by that jurisdiction have low-friction access to other major markets. For this goal to be achieved, the UK must focus hard on raising standards of regulation so UK consumers and regulators and politicians in other jurisdictions believe that it is well regulated and that standards of conduct (and of consumer redress in the would-be-rare instances of misconduct) are good. This objective requires significantly more enforcement against senior managers than has been evident under SM&CR.

Question 6: Are there examples of other regimes that the government could learn from?

As evidenced in the United States, a very successful and simple measure would be to adequately reward whistleblowers.

Question 7: How does the level of detail, sanctions and time devoted to the UK's SMCR regime compare with that in other significant financial centres?

The SM&CR regime forms part of a suite of regulatory measures that is more comprehensive than that of many other significant financial centres. The UK's historical success as a 'major

financial hub,' rests upon its distinguished reputation operating in a well-regulated and stable jurisdiction.

Question 8: Are there specific areas of the SM&CR that respondents have concerns about or which they believe are perceived as a deterrent to firms or individuals locating in the UK? If so, what potential solutions should be considered to address these? Respondents should provide as much detail as possible to help build the fullest picture of any issues.

SM&CR should act as a deterrent to firms and individuals locating in the UK that wish to operate under a less robust regulatory system.

We are aware of arguments that the SM&CR creates unnecessary regulatory friction, for example by increasing the time taken for regulators to authorise an individual's appointment to a new role. The SM&CR is also largely discredited as a branded initiative given the paucity of enforcement actions undertaken under it.

Question 9: Is the current scope of the SM&CR correct to achieve the aims of the regime? Are there opportunities to remove certain low risk activities or firms from its scope?

The scope is adequate, it is the application that determines whether or not the aims are achieved. As expressed throughout our response there has been a woeful lack of application.

Question 10: Are there "lessons learned" that government should consider as part of any future decisions on potential changes to the scope of the regime to ensure a smooth rollout to firms or parts of the financial services sector?

Yes. Any potential changes should be fully consulted on, and the handling of consultation responses should be cognisant of the fact that the financial industry is very well placed to provide a huge quantity of high-quality responses; whereas pro-consumer organisations such as ours are less well-equipped to respond.

This asymmetry of influence must be taken into account.

Question 11: Any other comments the government or regulators would benefit from receiving?

Have the right questions been asked in the right way?

The Introduction defines the purpose of the call for evidence as '*to ensure that HM Treasury, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) can build a joint evidence base upon which to consider future reforms to the regime'.*

Our concern is that, as set out in the introduction, there is an inappropriately narrow focus on certain aspects of the regime that have been brought to the government's attention by firms operating within the regime. One wonders what a Freedom of Information Request designed to reveal how many meetings with relevant Ministers had been had by those representing City interests versus those representing consumer interests would show; and of course it is perfectly clear that there has been a huge effort to influence by the sector - here's one relevant article from many that could have been chosen.

This narrow focus translates through to the wording and formulation of the questions themselves which would seem to be designed to facilitate the answers the government wishes to garner, i.e. they are 'leading questions'.

An example is Q 1. The guiding example asks if SM&CR has made it easier to hold individuals to account? This is a very different question to asking whether it has delivered against its core objectives. 2.9 identifies the primary objectives as reducing harm to consumers and strengthening market integrity. Holding individuals to account is the process that seeks to achieve this result.

If the direct question is asked: Has SM&CR achieved its primary objectives of reducing consumer harm and strengthening market integrity then this becomes an evidence- based question to which the answer is irrefutably 'No!'.

We would also strongly challenge the false premise made in 1.2: *The government also recognises that high standards of regulation and individual conduct are at the heart of the UK's long-standing success as a global financial hub.* This statement is not compatible with the shocking evidence of chronic and catastrophic regulatory failure in the UK financial sector demonstrated in Violation Tracker UK, Identifying long standing recidivism in our major financial institutions.

We would however agree with the statement that the government says it understands: *there is broad support for the principles and objectives underpinning the regime*.

Those principles, including individual accountability and providing an adequate level of consumer protection, enjoy wide support from consumer groups and Parliament as a whole.

Unfortunately, failure to establish those principles in practice has resulted, not through any major deficiencies in the SM&CR regime, but through a stark absence of enforcement by the regulator.

The empirical evidence shows that fines clearly do not act as a deterrent and are widely seen as a cost of doing business. If the regulator does not use its powers of enforcement against individuals in the major institutions, constituting a meaningful number of cases, then SM&CR has no deterrent effect and does not improve culture.

Failure to properly enforce regulations that Parliament has granted, and expects to be enforced, has the effect of undermining public confidence in the regulator and trust in the institutions that it has a duty to regulate. Confidence of SMEs, in particular that they can borrow and be treated fairly by the banks is key to economic growth and investment to increase productivity.

Continuing reluctance by the regulator to resolve historical malpractice of SMEs is a major stumbling block to restoring that confidence. Clearly the effective application of the SM&CR regime in this regard presents a golden opportunity to better deliver on the regime's core objectives.

TTF certainly shares the government's wishes to drive growth across the economy but prioritising financial services business's short term interests alone will not achieve this. Finance should responsibly partner and promote the wider economy not become the whole economy. It is abundantly clear that this route to prosperity will only succeed with a robust regulator which in turn is accountable to elected representatives. The SM&CR regime, consistent with its original aims, has a significant part to play in this by instilling a culture of compliance and good behaviour within firms. However, the dividend of reduced enforcement action, compliance burdens and reduced litigation expenditure for firms will only result from credible and consistent enforcement action by the regulator.

And of course the cost to the sector of the reputational damage that is created by poor conduct is immense.

The issue of international competitiveness in terms of its attractiveness as a destination for financial services business is raised in relation to SM&CR.

There are of course many interacting factors that determine the 'attractiveness' and all will be case-specific to any particular firm.

We question the extent to which individual accountability is a genuinely held concern of financial firms currently operating in the UK as an impediment to new entrants entering the marketplace.

The government expresses a similar contrary view, "*The government also recognises that high standards of regulation and individual conduct are at the heart of the UK's long-standing success as a global financial hub"*. Perhaps a more sincere position is that senior executives in financial firms would naturally wish to minimise the responsibilities under which they operate and see the 'international competitiveness' argument as a way of achieving this.

Neither do we view this a matter of serious concern for firms that may be considering conducting business in the UK. SM&CR should operate on a level playing field so new entrants would not operate at a competitive disadvantage.

Equally firms that operate in multiple jurisdictions are bound by the laws of the countries in which they operate and SM&CR has no impact on this.

One area of great concern is the process by which the FCA would implement its competitiveness objective under FSMA. It is not at all clear how this would operate in practice and of course this may have an impact on how the FCA enforces the provisions of the SM&CR.

The government has indicated that it would be in favour of holding the FCA accountable for achieving certain metrics with regard to its new secondary competitiveness objective. It has not indicated that it has the same appetite for ensuring that the consumer protection objectives are achieved. If accountability metrics are applied to the competitiveness 'objective' we would expect appropriate metrics to be applied to the other competing objectives at the same time.

Success for the Sector is best achieved through ensuring good outcomes for consumers

The Transparency Task Force operates a "North Star" question to guide its work, and that question is "What is best for the consumer?"

It is our firm belief that a financial sector that first and foremost considers the needs of the consumer will flourish with abundance - what is best for the consumer is ultimately also what is best for the sector.

We are genuinely concerned that deregulatory measures will lead to poor outcomes for consumers that in turn will lead to a failure to achieve the full potential for commercial success for the sector itself. We believe that deregulation in the short term leads to the likelihood of disasters in the long term. There is evidence for this. For example, the repeal of the Glass-Steagall Act is thought by some to have been a major contributory factor that led to the Global Financial Crisis; here's one article of many that could have been chosen.

Our thoughts around our "What is best for the consumer?" North Star Question in the context of HM Treasury's consideration of reforms for the Senior Managers & Certification Regime, could be summarised as follows:

'To have an efficient Financial Services Sector that functions in a clearly prescribed way under a stable and accountable regulatory environment. Regulation must be transparently applied with demonstrably effective deterrence measures to adequately protect the consumer. Regulatory responsibility and operation should not be conflicted with inherently competing interests between various stakeholders, including regulatory stakeholders'.

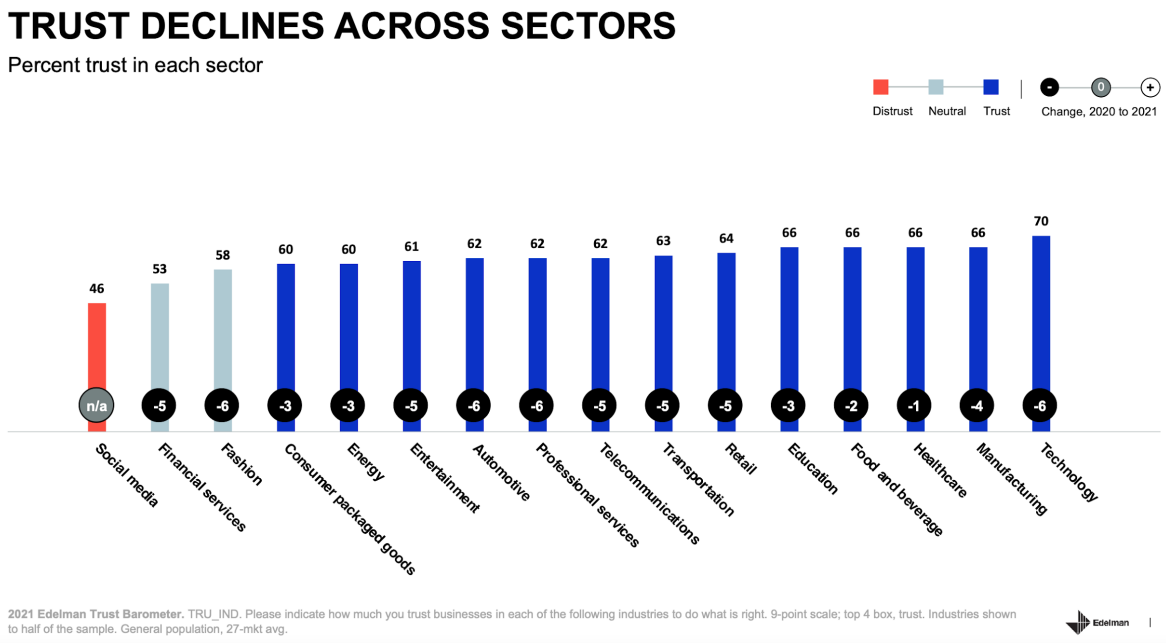
Given the fundamental need for the financial sector to be trusted for it to function successfully in supporting the economy and UK citizens, it should be of great concern for the sector's market participants, trade bodies, professional associations and regulators that it is a sector that society does not trust.

Lack of trust negatively impacts the regulatory objective of ensuring that the markets work well.

UK productivity (relative to hours worked) is significantly lower than our EU competitors for example Germany, this is accepted as a very serious problem resulting in UK firms being competitively disadvantaged. The regulators' failure to regulate and sanction translates into a failure to effectively impose deterrence to regulatory non-compliance. Clearly, this contributes to the undermining of UK productivity. A softening of regulation in the name of competitiveness would quite obviously lead to even lower investment and productivity.

"In the words of the Bank of England's Andrew Bailey in 2019, when he was CEO of the Financial Conduct Authority, the regulator "was required to consider the UK's competitiveness, and it didn't end well, for anyone'.

We believe that there is cause for concern about the reputational integrity of the financial services sector, in most parts of the world. There is ample evidence to suggest that society is distrusting of financial services. The highly credible 2021 Edelman Trust Barometer in Financial Services shows it to be the second most distrusted industry; second only to social media.



Given the fundamental need for the financial sector to be trusted for it to function successfully, it should be a great concern for the sector's market participants, trade bodies, professional associations and regulators that it is a sector that society does not trust.

It is easy to understand why the financial sector is distrusted; in fact the evidence suggests that people *should* distrust it. Consider for example the overall conduct of the financial industry in the UK compared to other industries when it comes to the level of violations.

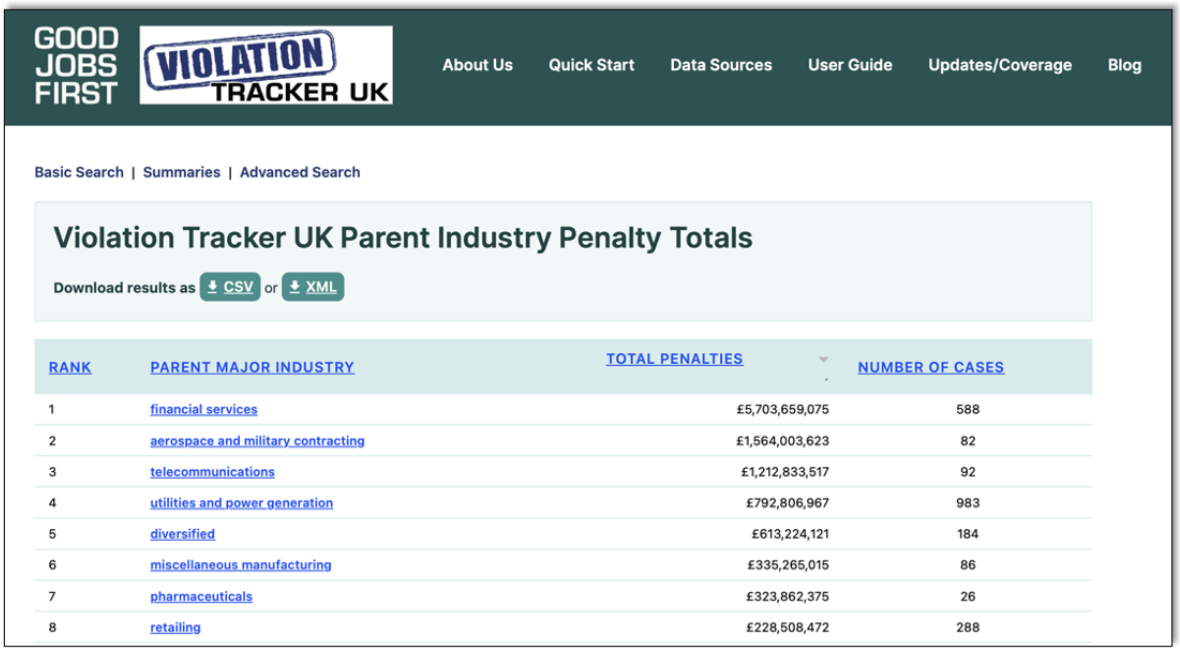
The best source for such data is the recently launched Violation Tracker UK, which has already been referred to. In the interests of transparency we should point out that

Transparency Task is very closely connected with Violation Tracker UK; and proudly so. For example, we Chair its UK Advisory Board.

Violation Tracker UK holds data about corporate infringements in 46 sectors. What does the data in Violation Tracker UK show about the UK's financial services sector? It shows that the conduct of the sector is so bad that if you add up all the infringements by all the other 45 industries it equates to roughly the same as the financial sector on its own.

That is a truly alarming reality; so much so that repairing the reputational integrity of the sector should be Priority #1 for all stakeholders that truly care for the wellbeing of the sector and the society it is meant to serve.

The screenshot below shows the top of a chart that all financial sector stakeholders in the UK should be embarrassed that the financial sector is at the top of:



RANK	PARENT MAJOR INDUSTRY	TOTAL PENALTIES	NUMBER OF CASES
1	financial services	£5,703,659,075	588
2	aerospace and military contracting	£1,564,003,623	82
3	telecommunications	£1,212,833,517	92
4	utilities and power generation	£792,806,967	983
5	diversified	£613,224,121	184
6	miscellaneous manufacturing	£335,265,015	86
7	pharmaceuticals	£323,862,375	26
8	retailing	£228,508,472	288

To view the chart in full, click here.

Furthermore, it is impossible to ignore the obvious question: how can it be, that despite the UK's financial sector being such a systemically important part of our economy and our international reputation, that we are tolerating such poor stewardship of it by its principal conduct regulator?

That question becomes even more poignant when you look deeper into the data held within Violation Tracker UK and consider the obvious pattern of recidivism that exists within the sector. The screenshot below gives a feel for the nature of the recidivism within the sector:

To see the evidence for widespread recidivism click here and when viewing it, scroll down and see the obvious pattern of the same organisations committing the same offences over and over again. Perhaps this suggests that there is a culture within the sector that sees the fines imposed on it as a cost of doing business. Perhaps this hard evidence also calls into question the lack of effectiveness of the Financial Conduct Authority in ensuring the sector behaves properly and that it succeeds in its objective to maintain the integrity of the sector and provide an appropriate level of consumer protection.

The validity of that line of thought becomes even more obvious when you drill down to the next level of infringement data, and look at the violations of particular organisations. For example, examine the infringements by Barclays, Lloyds Banking Group and Nat West; and ask yourself if it would be prudent to do anything that might encourage even more misconduct?

For the avoidance of any doubt the answer is "No"!

All this makes it perfectly clear that any notion of reforms that might lead to even worse conduct by the sector should be distinguished immediately as a reckless line of thought. The reputation of the financial sector and wealth it generates matter far too much for any reforms to be allowed to gamble with it. Rather, we would respectfully suggest that resource and energy would be better spent examining what needs to happen for the FCA, and thus the delivery of financial regulation in the UK, to become fit for purpose.

We believe that turning the UK's financial services industry into the world's best-regulated is the best way to restore consumer confidence in it and the UK, and to persuade governments and regulators overseas that the ghosts of the Global Financial Crisis have finally been laid to rest and that the City of London can be trusted to trade freely across borders. Thus, fixing UK financial regulation, rather than weakening the Senior Managers & Certification Regime is the most effective way to boost the performance of the industry.

Please therefore be mindful of these well-founded concerns when reading our response.

A short film about some of the underlying issues

The Transparency Task Force is very grateful to TTF UK Ambassador and Advisory Group member, JB Beckett who kindly produced a short film in 2022 that provides an excellent entrée into the main issues that this consultation and our response to it deals with.

It is of course now slightly out of date but the key points it makes are still relevant.

The film can be watched by clicking here.

"The Competitiveness Agenda; and why we need to push back on it"

Our general concerns about the deregulatory agenda are reflected in our January 2022 event about the topic. We are very grateful to the speakers, namely:

- David Pitt-Watson, Visiting Fellow, Cambridge Judge Business School
- JB Beckett, Non Executive Director & Author of "New Fund Order"
- Nicholas Shaxson, Author, journalist, investigator and co-founder of the Balanced Economy, an anti-monopoly organisation
- David T Llewellyn, Professor of Money and Banking; and former regulator
- Marloes Nicholls, Head of Policy and Advocacy, Finance Innovation Lab
- Mark Bishop, Leader, Connaught Action Group

The full video recording of the event can be watched by clicking here.

The Transparency Task Force is not alone in having serious concerns

The Transparency Task Force is one of 37 organisations that have issued a Joint Statement about our collective concerns regarding HM Treasury's Future Regulatory Framework proposals, which we believe provide the overarching framework into which the proposals for reform of the Senior Managers & Certification Regime.

You can get to the press release about the Joint Statement, which includes comments from several individuals including Sir Vince Cable, here. The Joint Statement here. We are proud to be amongst this collection of progressive organisations, each of which has its own set of reasons for concern about the proposals:

Further food for thought, that shouldn't be ignored

In his well-known and highly regarded 1994 article "Competitiveness: A Dangerous Obsession" Paul Krugman, then Professor of Economics at the Massachusetts Institute of Technology, set out a range of concerns that, whilst now decades old and of course US-focused still do a great job in skewering the woolly thinking behind the current calls for competitiveness.

Paul Krugman's comments below (almost all of which are from the 1994 article) capture the essence of his thinking on the topic very well.

We posit that the wisdom of such a highly-acclaimed, award-winning and highly relevant subject-matter expert should not be ignored.

- "If we can teach undergrads to wince when they hear someone talk about 'competitiveness,' we will have done our nation a great service."
- "A government wedded to the ideology of competitiveness is as unlikely to make good economic policy as a government committed to creationism is to make good science policy."
- "Countries are nothing at all like corporations….countries do not go out of business."
- "The rhetoric of competitiveness — the view that, in the words of President Clinton, each nation is "like a big corporation competing in the global marketplace" — has become pervasive among opinion leaders throughout the world. People who believe

themselves to be sophisticated about the subject take it for granted that the economic problem facing any modern nation is essentially one of competing on world markets."

- "The idea that a country's economic fortunes are largely determined by its success on world markets is a hypothesis, not a necessary truth; and as a practical, empirical matter, that hypothesis is flatly wrong."
- "The growing obsession in most advanced nations with international competitiveness should be seen, not as a well-founded concern, but as a view held in the face of overwhelming contrary evidence. And yet it is clearly a view that people very much want to hold."
- "The obsession with competitiveness is not only wrong but dangerous, skewing domestic policies and threatening the international economic system."
- "Most people who use the term "competitiveness" do so without a second thought."
- "Over and over again one finds books and articles on competitiveness that seem to the unwary reader to be full of convincing evidence but that strike anyone familiar with the data as strangely, almost eerily inept in their handling of the numbers."
- "In each case, the growth rate of living standards essentially equals the growth rate of domestic productivity — not productivity relative to competitors, but simply domestic productivity."
- "Competitiveness is a meaningless word when applied to national economies."

Further supporting testimony

TTF ran an event about this consultation on 9th May 2023.

The recording of it can be watched, it is available to view here.

The discussion covers a range of points that reinforce and augment the views being shared in this written response.

In particular, we would like to draw your attention to the comments made by Steve Middleton in relation to the powers available to the FCA to use the Approved Persons Rules (APER) to impose fines *against individuals* as shown here: 2016 fines | FCA and here: 2017 fines | FCA

We are left wondering:

- Has the APER regime also been an under-utilised set of powers?

- Has APER been overlooked i.e. how does the APER regime fit into HMT and FCA thinking about potential reforms to the SM&CR?

We are grateful to all the speakers:

- Mark Bishop, Leader of the Connaught Action Group, whose slides can be downloaded here
- David Llewellyn, Professor of Money & Banking, Loughborough University
- Steve Middleton, Bank Confidential

Concluding comments - the numbers 'say it all'

Since SM&CR started the FCA has imposed just one fine, one public censure, one prohibition and one undertaking on senior managers, as shown here.

The PRA has imposed just one fine, as shown here.

In public the FCA has rejected previous analysis focusing on its low caseload and enforcement record, but has failed to provide any alternative metric to justify its claims that the regime is helping to raise standards across the industry, see here.

Meanwhile, there is no public evidence that criminal investigations have been started using the criminal offence introduced alongside the regime, in the Financial Service (Banking Reform) Act 2013, for reckless mismanagement of a financial institution. This is despite the high profile collapses of Greensill Capital and London Capital & Finance in recent years.

Clearly, SM&CR has resulted in very little enforcement action against senior managers. The problem is not with the regime itself but with the poor use of it by the regulators.

We therefore suggest the regulators use it as originally envisaged (i.e. properly) and review the situation again in due course.