## The FCA has updated their Conduct Rules to reflect the higher standards of the Consumer Duty. Whilst shaping the behaviour of persons working in regulated firms and driving culture change it is important to ensure that individuals at all levels in a firm understand how they can act to deliver good outcomes for customers. These rules set basic standards of good personal conduct against which individuals will be held to account.

The Conduct rules apply to:

* A Senior Management Function (SMF)
* An individual performing a SMF for less than 12 weeks due to a temporary absence or unforeseen absence
* A certification employee of an SMCR firm
* All other employees other than ancillary staff

The Conduct Rules apply to the majority of employees working in SMCR firms because a broad range of staff have the potential to cause harm.

#### To what Conduct do the rules apply?

The Conduct Rules apply to the conduct of a person in relation to the activities they are performing on behalf of the firm who appointed them to the role. The activities can be regulated or unregulated.

The Conduct Rules do not apply to Appointed Representatives (ARs). The Approved Persons Regime continues to apply to ARs.

# Individual Conduct Rules (COCON 2.1)

## Rules 1-6 in COCON 2.1 apply to ALL Conduct Rules Staff

### You must act with integrity

A lack of integrity does not necessarily equate to dishonesty. While a person who acts dishonestly is obviously also acting without integrity, a person may lack integrity without being dishonest; for example, not caring whether a statement is true even though it is known that others will or may rely on the statement

Lack of integrity does not apply in a situation where there has been a conscious decision to take an acceptable risk

For clarity, a few examples of conduct that would be in breach of this rule follow:

* + **Misleading** or attempting to mislead by act or omission: a client, the firm, its auditors or regulators
  + **Falsifying** documents
  + **Misleading** others in the firm about the creditworthiness of a borrower
  + Providing **false** or **inaccurate** documentation or information including details of training,

qualifications, past employment record or experience

* + Providing **false** or **inaccurate** information to the firm, its auditors or the regulators
  + **Destroying** or causing the destruction of documents or tapes or their contents relevant to misleading a client, the firm or the regulators
  + **Misleading** others in the firm about the nature of risks being accepted
  + **Failing to inform** the relevant party of the fact that their understanding of a material issue is incorrect
  + **Misuse** of assets or confidential information of a client or of the firm
  + **Not paying due regard to the interests of the customer** (this is a rule in its own right)
  + **Acts, omissions** or **business practices** that could be reasonably expected to cause customer detriment

### You must act with due skill care and diligence

Although this rule applies to Senior Management Functions and Certificated Staff the expectations vary with the level of authority as set out in the examples below:

#### All Applicable Staff

The following are some examples of conduct that would breach this rule:

* + Failing to inform a customer, the firm or its auditors of material information in circumstances where the member of staff was aware, or ought to have been aware, of such information and of the fact that they should provide it including the following:

Failing to disclose details of the charges, mid-term adjustment fees or cancellation fees in respect of the product

Providing inaccurate or inadequate information to a firm or its auditors

* + Recommending a product where the member of staff does not have reasonable grounds to believe that the product will be suitable for that customer.
  + Failing to provide adequate control over client money including failing to segregate a clients’ money and failing to process client payments in a timely manner.
  + Continuing to perform a function having failed to meet the standards of knowledge and skill in the T & C Sourcebook.

#### Manager Rule 2

A manager must understand the business for which they are responsible. They do not need to be an expert in all aspects however; they should understand and inform themselves about the business sufficiently to understand the risks of its trading, credit or other business activities.

It is important to understand the risks of expanding the business into new areas and before approving the expansion, a manager should investigate and satisfy themselves about the risks to the business if any.

Where unusually profitable business is undertaken, or where the profits are particularly volatile or the business involves funding requirements beyond those reasonably anticipated, a manager should require explanations and where these explanation are implausible or unsatisfactory they should take steps to test the reliability of those explanations.

A manager should perform the above duties with a view to ensuring that retail customers receive good outcomes.

For clarity the following are some examples where a manager may be in breach of Rule 2

* + Failing to take reasonable steps to ensure that the business of the firm for which the manager has responsibility:-
    - Is controlled effectively
    - Complies with the relevant requirements and standards of the regulatory system
    - Is conducted in a way to ensure that any delegation of responsibilities is to an appropriate person and is overseen effectively
  + Failing to take reasonable steps to adequately inform themselves about the affairs of the business for which they are responsible including:
    - permitting expansion for the business without assessing the potential risks,
    - inadequately monitoring highly profitable transactions or business practices or unusual transactions or business practices,
    - accepting implausible or unsatisfactory explanations from subordinates without testing the veracity of those explanations and
    - failing to obtain an independent expert opinion where appropriate.
  + Failing to take reasonable steps to maintain an appropriate level of understanding about an issue or part of the business that the manager has delegated to an individual or individuals

#### Board Rule 2

Members of the board are expected to act with due skill, care and diligence. This rule applies to a director whether executive or non-executive when taking part in the activities of the board, other governing body or of its committees. This includes, for example, participating in meetings, preparing papers or other submissions for a meeting and reporting to the board or committee.

### You must be open and cooperative with the FCA, the PRA and other regulators

There is no duty on a person to report information directly to the regulator concerned unless this is part of their role.

However, if a person takes steps to influence the decision not to report the information to the regulator or acts in a way that is intended to obstruct the reporting of the information then they will be viewed as having taken on responsibility for deciding whether to report that matter to the regulator.

For clarity the following are examples of behaviour that would be considered a breach of this rule:

* + Failing to report promptly information in response to questions from the FCA or PRA.
  + Failing without good reason to:
    - inform the regulator of information of which the approved person was aware in response to the questions from the regulator,
    - attend an interview or answer questions put by a regulator despite a request or demand having been made,
    - supply a regulator with appropriate documents or information when requested or required to do so and within the time limits attaching to that request or requirement.

Good reason could include, where applicable, a right to protect legal professional privilege, a right to avoid self-incrimination, complying with an order of a court or complying with an obligation imposed by law or by a regulator.

### You must pay due regard to the interests of customers and treat them fairly

This applies to ALL Conduct rule staff regardless of whether that person has direct contact or dealings with the customer of the firm. Staff must consider how their actions (or inactions), can affect the interests of customers or result in customers being treated unfairly.

For clarity the following are some examples of conduct that might breach this rule:

* + Failing to inform a customer of material information in circumstances where they, the member of conduct staff, were or ought to have been aware, of such information and of the fact that they should

provide it – for example; providing inaccurate or inadequate information to a customer about a product or service.

* + Undertaking, recommending or providing advice on transactions without a reasonable understanding of the risk exposure of the transaction to a customer.
  + Failing to provide adequate control over a clients assets (client money)
  + Providing the customer with a product which is different to the one applied for unless the customer understands the differences and understands the product they have purchased.
  + Failing to acknowledge, or seek to resolve, mistakes in dealing with customers.
  + Failing to provide terms and conditions to which a product or service is subject in a way which is clear and easy for the customer to understand.

### You must observe proper standards of market conduct

If the firm or the individual comply with relevant regulatory requirements (FCA Rules), market codes and exchange rules then this will normally show compliance with this rule.

### You must act to deliver good outcomes for retail customers

This applies to ALL Conduct rule staff regardless of whether that person has direct contact or dealings with the customer or prospective customer of the firm.

The Conduct rule also applies where the customer is not a direct client of the firm and there is no direct relationship. This means the duty applies wherever the firm sits in the distribution chain.

The firm should consider how actions (or inactions) can affect the interests of retail customers or result in retail customers not obtaining a good outcome.

This rule imposes a higher and more exacting standard of conduct in relation to the firms business than Rule 4. It also has a broader application with a greater focus on consumer protection outcomes for retail customers including where those customers do not stand in a client relationship with the firm, but the firm is part of the distribution chain.

The rules in respect of the Consumer Duty Principle and the guidance in respect of the Cross-Cutting Rules will be helpful in interpreting the requirements of Conduct Rule 6 which requires you to: -

* Act in good faith toward retail customers
* Avoid causing foreseeable harm to retail customers
* Enable and support retail customer to pursue their financial objectives.

A standard of reasonableness applies which means that this rule should be interpreted with the standards that could reasonably be expected of a prudent firm:

1. carrying on the same activity in relation to the same product; and
2. taking appropriate account of the needs and characteristics of retail customers based on the needs and characteristics of retail customers in the relevant target market or of individual retail customers as the context requires.

Factors relevant to this standard expected of ALL Conduct rules staff include:

1. their seniority;
2. the scope of their job and in particular the degree to which the responsibilities of the job are able to affect the outcomes experienced by retail customers;
3. their level of expertise and experience;
4. the expertise and experience that their firm reasonably expects them to have;
5. the expertise and experience that their firm should (under the regulatory system) ensure they have; and
6. the degree of discretion and judgment the person has in their job, including, for example, whether they are bound to a script or process when dealing with retail customers and how much discretion and judgment any such script or process leaves to them.

For clarity the following are some examples of factors relevant to this standard expected of all conduct staff: -

* Someone in a management position is likely to have a greater ability to influence the outcomes experiences by retail customers.
* The ability of a manager of a business area to achieve good outcomes for retail customers is likely to reflect the ability of their business area to do so.
* Seniority may be relevant to the extent to which it is reasonable for a member of a staff to be expected to: -
  + - Analyse how their area of responsibility fits into the overall systems and processes for ensuring good outcomes for retail customers
    - Analyse the policies and procedures about retail customers the firm imposes on an employee and on the part of the business in which they work and
    - Make suggestions for changes to those things.
* Seniority may be relevant to the extend to which it is reasonable to expect a member of staff to be concerned with policies and procedures about retail customers on a firm wide basis and not just for their area of direct responsibility.
* A salesperson of a member of the customer support staff is likely to have a significant influence on the outcomes that a retail customer receives even if they are junior or subject to a detailed set of procedures.

# Senior Manager Conduct Rules (COCON 2.2)

## Senior Managers must abide by the Individual Conduct Rules and the following Senior Manager Conduct Rules. However, SC1-SC3 do not apply to Non-Executive Directors unless they are also an SMF Manager or perform another SMF function.

#### SC1: You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively

A Senior Management Function (SMF) manager’s roles and responsibilities are set out in their Statement of Responsibilities (SoR).

Strategy and Plans will often dictate the risk which the business is prepared to take on and high-level controls will dictate how the business is to be run.

If the strategy of the business is to enter high risk areas, then the degree of control and strength of monitoring within the business will be high.

Senior conduct rules staff members may find it helpful to review whether each area of the business, for which they are responsible, has been clearly assigned to a particular individual or individuals.

The organisation of the business and the responsibilities of those within it should be clearly defined. Reporting lines should be clear to staff. Where there are dual reporting lines there is a greater need to ensure that the responsibility and accountability of each individual line manager is clearly understood.

Where there are particular levels of authorisation these should be clearly set out and communicated to staff. Job descriptions should be in place.

Senior Conduct Rules staff must ensure that each area of the business for which they are responsible has appropriate policies and procedures for reviewing the competence, knowledge, skills and performance of each individual member of staff.

If an individual’s performance is unsatisfactory, the relevant senior conduct rules staff member should review carefully whether to allow that individual to continue in their position. An adequate investigation should be undertaken. Continuing to perform a function having failed to meet the standards of knowledge and skill is not seen as acting with due skill care and diligence (see Conduct Rule 2).

As part of organising the business there must be an orderly transition when an SMF ceases to perform a function and someone else takes up that function. Comprehensive handover notes should be drawn up for the successor.

The notes should, at a minimum, specify any matter that is ongoing, which the successor should be aware of in order to perform their function effectively; ensure compliance with the requirements and standards of the regulatory system and ensure that the individual with overall responsibility for that part of the business of the firm maintains effective control.

To clarify, the following are examples of conduct that would be a breach of rule SC1:

1. Failing to take reasonable steps to apportion responsibilities for all areas of the business under the approved person’s control.
2. Failing to take reasonable steps to apportion responsibilities clearly among those to whom responsibilities have been delegated,
   * 1. Reporting lines must be clear
     2. Authorisation levels must be clear
     3. Job descriptions and responsibilities must be documented and clear.
3. Failing to take reasonable care to maintain a clear and appropriate apportionment of responsibilities including:
4. Failing to review regularly the responsibilities which have been apportioned; and
5. Failing to act where that review shows that those responsibilities have not been clearly apportioned.
6. Failing to take reasonable steps to ensure that suitable individuals are responsible for those aspects of the business under the control of senior conduct rules staff member, including the following:
7. Failing to review the competence, knowledge, skills and performance of staff to assess their suitability to fulfil their duties, despite evidence that their performance is unacceptable;
8. Giving undue weight to financial performance when considering the suitability or continuing suitability of an individual for a particular role; and
9. Allowing managerial vacancies which put compliance with the requirements and standards of the regulatory system at risk to remain, without arranging suitable cover for the responsibilities.

#### SC2: You must 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.

Senior conduct rules staff members do not themselves need to put in place the systems of control for the business unless it is within their roles and responsibilities.

However, they do need to ensure that the business for which they are responsible has operating procedures and systems with well-defined steps for complying with the detail of relevant requirements and standards of the regulatory system.

Where a senior conduct rules staff member becomes aware of actual or suspected problems that involve possible breaches of relevant requirements and standards of the regulatory system within their area of responsibility, they should take reasonable steps to ensure that they are dealt with in a timely and appropriate manner.

This may involve an adequate investigation to find out whether any systems or procedures have failed and why.

It may be necessary to take legal advice.

Where independent reviews of systems and procedures result in recommendations for improvement, the senior conduct rules staff member should ensure that, unless there are good reasons not to, any reasonable recommendations are implemented in a timely manner.

For clarity, the following are examples of conduct that would be in breach of rule SC2

1. Failing to take reasonable steps to implement (either personally or through a compliance department
2. or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the regulatory system for the activities of the firm.
3. Failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the regulatory system for the activities of the firm in question.
4. Failing to take reasonable steps to inform themselves adequately about the reason why significant breaches (suspected or actual) of the relevant requirements and standards of the regulatory system for the activities of the firm may have arisen (taking account of the systems and procedures in place).
5. Failing to take reasonable steps to ensure that procedures and systems of control are reviewed and, if appropriate, improved, following the identification of significant breaches including:
6. Unreasonably failing to implement recommendations for improvements in systems and procedures; and
7. Unreasonably failing to implement recommendations for improvements to systems and procedures in a timely manner.
8. For a manager with responsibility for overseeing the establishment and maintenance of appropriate systems and controls or the apportionment of responsibilities, any failure to take reasonable care to ensure that those obligations are discharged effectively.
9. For a senior conduct rules staff member who is responsible for the compliance function, failing to ensure that:
10. the compliance function has the necessary authority, resources, expertise and access to all relevant information; or
11. a compliance officer is appointed and is responsible for the compliance function and for any reporting as to compliance; or
12. the persons involved in the compliance functions are not involved in the performance of services or activities they monitor; or
13. the method of determining the remuneration of the persons involved in the compliance function does not compromise their objectivity.

#### SC3: You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.

A senior conduct rules staff member should have reasonable grounds for believing that the delegate has the competence, knowledge, skill and time to deal with the issue. For example if the compliance department only has the resources to deal with day to day issues, it would be unreasonable to delegate to it the resolution of a complex or unusual issue without ensuring it had sufficient capacity to deal with the matter.

The FCA does recognise that Senior Conduct rules staff will have to use their own judgement and that sometimes with hindsight this will be wrong. This may not be a breach of rule SC3 unless they fail to exercise due and reasonable consideration before they delegate and have reached a reasonable conclusion. This is not a blame culture it is encouraging you to think before you act and be able to demonstrate the thought process.

The rule book actually states that firms can speak to the FCA to discuss approaches to compliance problems, although they cannot delegate to the FCA.

Senior Conduct Rules Staff will not always manage the business day-to-day. It will depend on the nature scale and complexity of the business and their position within it. However, there is a need for clear and effective delegation and reporting lines, especially in larger and more complex businesses. This will involve documenting the scope of that delegation (authority levels) and reporting lines. Systems must be in place to ensure that issues are being addressed at the appropriate level. When issues come to the senior manager’s attention they should be addressed.

Delegating the authority for dealing with an issue, or a part of the business to an individual or individuals (whether in-house or outside) without reasonable grounds for believing that the delegate has the necessary capacity, competence, knowledge, seniority or skill to deal with the issue indicates a failure to comply with Rule SC3.

### Remember, although you can delegate the resolution of an issue or the authority for dealing with an issue, you cannot delegate responsibility for it.

You need to receive reports on progress and question the reports. If an issue is not being resolved the senior conduct rules staff member may need to challenge the explanations and if necessary take action to resolve the problem. This may mean increasing resources applied to it, reassigning the resolution internally or obtaining external advice or assistance. Action needs to be decisive and appropriate.

For clarity, the following are examples of conduct that would be in breach of rule SC3

1. Failing to take reasonable steps to maintain an appropriate level of understanding about an issue or part of the business that has been delegated including:
2. disregarding an issue or part of the business once it has been delegated;
3. failing to require adequate reports once the resolution of an issue or management of part of the business has been delegated; and
4. accepting implausible or unsatisfactory explanations from delegates without testing their accuracy.
5. Failing to supervise and monitor adequately the individual(s) to whom responsibility for dealing with an issue or authority for dealing with a part of the business has been delegated including any failure to:
6. take personal action where progress is unreasonably slow, or where implausible or unsatisfactory explanations are provided; or
7. review the performance of an outside contractor in connection with the delegated issue or business.

In determining whether or not the conduct of a senior conduct rules staff member complies with rule SC3 the FCA would expect the following to be taken into account:-

1. The delegate’s competence, knowledge or seniority
2. The past performance and record of the delegate.

#### SC4: You must disclose appropriately, any information of which the FCA or PRA would reasonably expect notice.

Regulators in addition to the FCA and PRA are those which have recognised jurisdiction in relation to activities to which the conduct rules apply and have a power to call for information from the relevant person in connection with their function of the business for which they are responsible. This may include an exchange or an overseas regulator.

Although there is some overlap with Rule 3 (individual conduct rule) they are different. Rule 3 normally relates to responses from individuals to requests from their regulator whereas SC4 imposes a duty on a SMF to disclose appropriately any information of which the regulator would reasonably expect, including making a disclosure in the absence of any request or enquiry.

An SMF is likely to have access to greater information of regulatory importance and have the expertise to recognise when this may be something of which the appropriate regulator would expect notice.

Where an SMF is responsible for reporting matters to the regulator, failing to do so promptly constitutes a breach.

If an SMF comes across a piece of information that they think their regulator would expect them to give notice they should assess whether the information falls within the scope of their responsibilities as set out in their SoR. If it does they should ensure it is disclosed.

If it does not fall within their SoR they might reasonably assume that the disclosure is being dealt with by the SMF with the appropriate responsibility. But check, don’t just assume – the FCA would expect you to make enquiries to inform yourself.

In deciding whether or not a person’s conduct complies with Rule SC4 the FCA would expect the following to be taken into account:-

1. Whether it would be reasonable for the individual to assume that the information would be of material significance to the regulator.
2. Whether the information is related to the individual themselves or to their firm; and
3. Whether any decision not to report the matter was taken after reasonable enquiry and analysis of the situation.

# Breaches of The Conduct Rules and notifying the FCA (SUP 15.3 & SUP 15.11

Firms need to notify the FCA when disciplinary action has been taken for conduct rule breaches.

For individuals who are not senior managers there is an annual reporting requirement, and this report is called REP008 and is completed and submitted by the firm using RegData. The firm must submit REP008 even if there have not been any conduct rule breaches resulting in disciplinary action – this will be a Nil Return.

Conduct rule breaches by senior managers resulting in disciplinary action must be reported on Connect using form D or form C (where the individual no longer performs a senior management function).

When assessing compliance with, or a breach of a conduct rule the FCA will have regard to the context in which a course of conduct was undertaken including:-

1. The precise circumstances of the individual case
2. The characteristics of the particular function performed by the individual in question and
3. The behaviour expected in that function.

A person will only be in breach of any of the conduct rules where they are personally culpable. Personal culpability arises where:

1. A person’s conduct was deliberate or
2. The person’s standard of conduct was below that which would be reasonable in all the circumstances.

In deciding whether or not the conduct of a person complies with the Conduct Rules the following would be taken into account:

1. Whether that conduct relates to activities that are subject to other provisions of the Handbook
2. Whether the conduct is consistent with the requirements and standards of the regulatory system relevant to the person’s firm.

In deciding whether the conduct of a SMF complies with SC1 – SC4 the following would be taken into account:-

1. Whether they exercised reasonable care when considering the information available to them
2. Whether they reached a reasonable conclusion upon which to act
3. The nature scale and complexity of the firm’s business
4. Their role and responsibility as determined by reference to the relevant statement of responsibility
5. The knowledge they had, or should have had, or regulatory concerns, if any, relating to their role and responsibilities.

In respect of SC3 & SC4 the smaller and less complex the business, the less detailed and extensive the systems of control need to be.

Firms listed on the London Stock Exchange will be subject to the COCON rules and the UK Corporate Governance Code.

**Training**

Firms must notify all persons subject to the Conduct Rules of the specific rules that apply to them and take all reasonable steps to ensure that those persons understand how the rules apply to them.

The steps a firm must take include the provision of suitable training. The training must ensure awareness of and a broad understanding of all the rules and that they have a deeper understanding of the practical application of the specific rules which are relevant to their work.

Knowledge should be reassessed at regular intervals.

If you have any questions regarding any aspect of FCA Compliance, please do not hesitate to contact a member of the Cobra Network Compliance team.

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