

MARSH INSIGHTS:

THE FINANCIAL SERVICES (BANKING REFORM) ACT 2013

Senior bank executives can face new burdens and heavier penalties when things go wrong.

OVERVIEW

The Financial Services (Banking Reform) Act 2013 received Royal Assent in December of the same year and will bring sweeping changes to the banking system, including a “ring-fence” around the deposits of people and small businesses to separate the high street from the trading floor. It will also seek and protect taxpayers when things go wrong and giving the government power to ensure that banks are better able to absorb losses.

However, by far the most sweeping reform is to banking standards. This includes the overhaul of the regulatory Approved Persons Regime, new rules of conduct, and a focus on holding individual decision makers accountable.

The new changes will apply to all banks and bank-holding companies operating in the UK. The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) expect to have the new rules in place during 2014, with the aim of implementing them in 2015.

SENIOR PERSONS REGIME

The Senior Persons Regime (SPR) aims to ensure that key responsibilities within banks are assigned to specific individuals who are fully aware of those responsibilities and have formally accepted them, and that individuals will

subsequently be held accountable for how they carry those responsibilities out. The SPR will also replace the current “Significant Influence Functions of the Approved Persons Regime”, regulating the performance of controlled functions at an authorised UK firm. As it will only apply to the most senior individuals (such as board and executive committee members), the SPR will not have such a wide reach as the current Approved Persons Regime.

Other key features of the SPR are as follows:

- Senior persons will need prior regulatory approval.
- All applications to perform a Senior Person function will be supplemented by a “statement of responsibilities,” specifying all the affairs of the firm that the individual is accountable for. Banks will have an ongoing obligation to keep this statement up to date.
- When an individual leaves a role, a handover certificate will be required, detailing how those responsibilities will be met and any issues of which they are aware.
- All bank staff with responsibilities could be held accountable.

Although the SPR is likely to capture a smaller number of key individuals than the current Approved Persons

Regime, the remaining pool of employees currently considered Approved Persons are likely to be subject to “licensing arrangements” based on a set of individual standard rules to be set out by the regulators. These persons could face enforcement actions if they do not comply.

TOUGHER PENALTIES

The most significant changes that represent key exposures for individuals are as follows:

- The proposed criminal sanction for reckless misconduct in the management of a bank:
 - This offence will only be applicable in cases involving the most serious failings.
 - It will only apply to those decisions which lead to the failure of a bank.
 - Those found guilty could be sentenced to up to seven years imprisonment and/or face an unlimited fine.
- The reversal of burden of proof:
 - Once the FCA concludes that a bank was in breach, enforcement actions could be taken against the senior person accountable for the function in which the

contravention occurred. The burden of proof will then need to be reversed and the individual will need to prove that they took all reasonable steps to prevent or mitigate wrongdoing. However, the burden of proof can only be reversed in civil cases, not criminal. The likely result of this new procedural step is that individual defence costs bills are likely to increase.

HOW WILL YOUR DIRECTORS AND OFFICERS (D&O) POLICY RESPOND?

The SPR is likely to result in more enforcement actions against individuals and greater exposure to shareholder claims. Typical D&O policies can provide coverage to respond to the new exposures faced by senior managers. Insureds should review their current D&O arrangements carefully to ensure their insurance arrangements respond so that:

- The policy should clearly cover all individuals captured by the SPR.
- Cover should extend to all employees who may be impacted by the new licensing rules and potential enforcement actions.
- Regulatory proceedings or enforcement actions brought by the FCA or PRA should trigger defence

costs coverage under the policy. If there are allegations of criminal conduct or fraud by a senior individual, then the policy should provide cover for the individual to fund their defence costs until the fraudulent actions are established by final non-appealable adjudication.

- At this stage, it is unclear whether the fines and penalties levied under the proposed regime will be civil, criminal, or a combination of both. Insureds should check to see the extent to which they have cover for fines and penalties under their current insurance arrangements.

SUMMARY

Under the new Banking Reform Act, senior bank executives face the prospect of new burdens and heavier penalties when things go wrong; most notably by way of a new criminal offence, and a presumption of guilt until proven innocent for some forms of misconduct in civil cases. Insureds should check their current D&O arrangements carefully to ensure that their coverage responds to the new risks that they face.

CONTACT

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