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UK Senior Managers Regime Encourages SEC Whistleblowing

By Richard Pike

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Nearly 12% of tips received by the Securities and Exchange Commission (SEC) in FY 2018 were from international whistleblowers and the second largest source of these tips was the United Kingdom[1]. The frequency of tips from the UK should come as no surprise because London is, of course, an important global financial center and many large firms operating in London are listed on US exchanges. We believe, however, that there may be another factor affecting the number of tips and one which is likely to play a much stronger role in the future.

UK Attitudes Towards Whistleblowing

The UK does not have a particularly strong tradition of whistleblowing. With a few small exceptions, whistleblowers do not receive any financial rewards from UK regulators for making disclosures. Proposals to introduce rewards have met resistance from the Establishment and even, sometimes, from bodies that claim to represent whistleblowers themselves. There's a suggestion that it would "not be cricket" to make a personal financial gain from a disclosure and that the possibility of financial gains might even be off-putting for persons looking to act out of purely altruistic motives. We might (and do) disagree, but the UK's position remains unchanged – at least for the time being.

Whistleblowers do have some protection against retaliation under UK employment law but the UK government has acknowledged that there are serious concerns about the effectiveness of the legislation.

Under the circumstances, one can hardly fault a UK employee for deciding to stay silent – especially if that person stands to lose a highly lucrative career by speaking-out. It is a testament to the bravery of whistleblowers that some still come forward.

Introduction of the Senior Managers Regime

Against this background, the Senior Managers & Certification Regime, which is more commonly referred to as the Senior Managers Regime or SMR, was introduced in 2016.

The SMR is the responsibility of the UK's Financial Conduct Authority (FCA) and is not focused wholly, or even mainly, on whistleblowing. The SMR was designed to improve culture, governance and accountability within financial services firms in the wake of the global financial crisis. It aims to deter misconduct by improving accountability and awareness of conduct issues across firms. Part of the idea is to ensure that it is always clear who is responsible for particular functions within firms, so that enforcement actions can be directed at the individuals actually responsible for the misconduct and not just at the firms.

The FCA simultaneously introduced a new requirement to put in place a whistleblower program at each of the relevant firms including a "whistleblower champion" answerable to the FCA under the SMR for the effectiveness of the program.[2] Firms are now required to have their own effective internal whistleblower programs and to inform employees of the scope to raise concerns with regulators.

The net result of these reforms is that all employees are (at least in theory) better informed about the rules and how to report violations of them. This should mean that senior managers are more likely to hear of issues. Further, each senior manager should be aware that the buck stops with her for any issues within her clearly-defined area of responsibility. As such, she will need to address concerns promptly and effectively or face criticism for allowing the

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1. Appendix C, 2018 Annual Report to Congress on the Whistleblower Program (SEC, November 2018).
2. *Whistleblowing in deposit-takers, PRA-designated investment firms and insurers* (PS15/24, October 2015).

underlying conduct to continue. She may also perceive an increased risk that her staff will go directly to the FCA if she does not do so and/or effectively address the issue without doing so. There is far less scope to take the ostrich approach of burying one's head in the sand, hoping that someone else will deal with the issue.

Additionally there is an element of the SMR that is specifically directed at increasing disclosure ofwrongdoing. Rule SC4 requires relevant senior managers to "*disclose appropriately any information of which the FCA or PRA*[3] *would reasonably expect notice*". This means, in some cases, that managers must make a direct disclosure to the regulator without waiting for any request or enquiry. Moreover, FCA guidance clarifies that to "*disclose appropriately*" a manager may be required to disclose wrongdoing to foreign regulators.[4]

Impact on Whistleblower Incentives

Failure to comply with Rule SC4 can result in individual fines and loss of the certification that allows a person to hold a senior role in the UK financial services industry. As such, it represents quite a big "stick" to go alongside the meagre "carrots" offered by UK employment law.

Once a manager is required to make a disclosure to UK regulators, in order to avoid individual enforcement action under the SMR, there's obviously little (if anything) to be lost in making a simultaneous disclosure to US regulators (if the disclosed conduct is of interest to them as well). We have received a number of inquiries about this exact situation – where a manager has decided that she should make a disclosure to the FCA and is looking to see if she might at least be able to gain some financial compensation under the US whistleblower reward programs to off-set the often negative consequences of the required disclosure to the FCA.

In many other cases, managers first hear about the US whistleblower reward programs[5] when consulting with lawyers about the UK disclosure requirements. At least somewhat to the chagrin of the FCA, the SMR is increasing awareness of the US whistleblower reward programs!

The Growing Significance of the SMR

When the SMR was first brought into force, in March 2016, it applied only to banks. But it is now being rolled-out to cover essentially all entities regulated by the FCA. Insurers were brought within the SMR's regime in December 2018, and all of the other firms regulated by the FCA will be subject to the SMR by the end of this year. Thus, by the end of the year there will be approximately 63,000 firms that have to comply with the SMR, compared to just 8,000 firms now.[6]

Many of the additional 55,000 firms will be significantly smaller businesses than the 8,000 firms already subject to the SMR, but that will actually mean that a greater proportion of their workforce will have to comply with Rule SC4. In banks, typically only the highest two levels of management have to comply with Rule SC4 but in a smaller firm that may mean that all or nearly all the financial service professionals are caught because there are a lot of responsibilities that must be assigned to specific staff members and only a small number of staff who are qualified to take them on. Further, whilst the banks may have attracted the biggest SEC fines over the years, it is often smaller firms that commit the more straightforward rule breaches – not least since their compliance systems may be less sophisticated.

One way or another, we expect there will be a significant up-tick in disclosures and, as long as there are no financial awards in the UK, increased disclosure in the UK is bound to continue fuelling interest in the US whistleblower reward programs.

3. The Prudential Regulation Authority, another UK financial services regulatory body.
4. *Paragraph 4.2.25, Code of Conduct (COCON), (FCA, Release 38 dated April 2019).*
5. Like the SEC, the CFTC and IRS also pay financial awards to whistleblowers who submit tips that help the agency bring a successful enforcement action. In July 2016, the Ontario Securities Commission (OSC) took a page from the SEC's book and launched a whistleblower reward program encouraging whistleblowers to bring the OSC information about securities law violations by companies listed on the Toronto Stock Exchange
6. *"Whistle-blower reports to the FCA rise 24% in a year to 1,755"* (BDO press release, 4 March 2019).