



A ROCK AND A HARD PLACE

Striking a balance between duties to an employer and obligations to the Financial Services Authority – and knowing when to blow the whistle – can be difficult. **Elizabeth Budd, Vincent Mercer and Noel Deans** of law firm Speechly Bircham shed some light on the matter

People in the financial services industry – in particular Financial Services Authority (FSA) approved persons – may get caught between their duties and obligations to their employer, and their duties and obligations to the FSA. Is it possible to reconcile these two, potentially conflicting, responsibilities?

Employee duties

An employee's duty to their employer may be explicit under a contract of employment, which can be verbal, or implied by law.

A contract of employment could be a combination of documents, such as the staff handbook, compliance manual, and an initial employment contract, including any amendments to that contract, such as revisions to pay, job description or title. In addition, new minimum statutory disciplinary and grievance procedures came into force in October last year. Though not necessarily terms of the contract, there are consequences for both the employer and employee for not following these procedures.

Under common law, an employee's implied duties include being expected to obey the employer's reasonable demands, being competent to carry out their role and taking care in doing so, being loyal and being honest. This means not making a secret profit from employment. There is also a mutual implied duty of trust and confidence, and a duty of confidentiality.

If an employer or employee breaches either an employment contract or common law duties, the courts may order damages, reinstatement or injunction, depending on the nature of the breach.

Approved persons' regime

One of the most significant changes introduced by the Financial Services and Markets Act 2000 was the introduction of the approved persons' regime. This placed a direct obligation on certain individuals with client-facing or management responsibilities to comply with the requirements of the FSA.

The approved persons' regime is based on seven principles of behaviour and a Code of Conduct. For employees coming under fire from both sides,

Principle 4 is particularly relevant:

"An approved person must deal with the FSA and with other regulators in an open and co-operative way and must disclose appropriately any information of which the FSA would reasonably expect notice."

The Code of Conduct adds that, unless an approved person has a reporting responsibility to the FSA, reporting to their appropriate line manager is sufficient. In many instances, this will be the compliance officer or a senior manager; though obviously this may not be sufficient if it is the line manager who is the cause of concern.

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An approved person can also only be in breach of one of the seven principles if they are personally culpable – for example, if their conduct was deliberate or below a reasonable standard.

A recent enforcement action regarding the approved persons regime involved Credit Suisse First Boston International (CSFB), and its employees, compliance officer Anthony Blunden, head of financial control Robert Stephens and Christopher Goekjian, the former CEO.

CSFB's Tokyo branch was involved in marketing structured notes to Japanese customers. The marketing did not comply with Japanese regulatory requirements and the Tokyo branch also attempted to conceal the activities from the Japanese regulatory

authorities. Even though the matter arose in Japan and did not directly concern UK regulatory authorities, the FSA decided that the activities in Tokyo merited direct action, and found all three in breach of FSA rules.

Blunden, as compliance officer, was considered not to have taken the necessary remedial action and was therefore prohibited from holding a compliance function. Stephens was found guilty of trying to mislead the Japanese tax authorities and therefore could not be regarded as fit and proper. Goekjian was found to have failed to supervise his staff properly and was fined £150,000. It is questionable whether or not these individuals were also in breach of their employment contracts.

This case highlights the importance of approved persons acting compliantly. Behaviour goes beyond national boundaries and the FSA will look at the individual's success in creating and maintaining a culture of compliance.


Creating a compliance culture

The desire to create a compliance culture has been around for many years. The FSA now has four statutory regulatory objectives, aimed at developing such a culture:

- maintaining confidence in the financial system
- securing the appropriate degree of protection for consumers
- reducing financial crime
- promoting public understanding of the financial system.

Under the FSA's 11 Principles of Business, a compliance culture is emphasised by Principles 3 and 11. These state respectively:

- a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems
- a firm must deal with its regulators in an open and co-operative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

The two principles are covered in detail by FSA Rulebooks covering Approved Persons, Fitness and Propriety, Systems and Controls and Training and Compliance. 

The Systems and Controls Rulebook requires that:

A firm must take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that:

- it is clear who has which of those responsibilities, and
- the business in the firm may be adequately monitored and controlled by the directors, relevant senior managers and governing body of the firm.

This is a fundamental requirement of the regulatory regime.

The Training and Compliance Rulebook requires that individuals are competent to carry out their role. This is more than simply knowing how to trade or manage investments – it also includes learning how to think compliantly, too

In October 2002, the FSA took compliance culture one stage further by issuing Discussion Paper 18: *An Ethical Framework for Financial Services*. To a certain extent this built on the work already carried out by the Securities and Investment Institute's Integrity and Ethics Committee in its publication *Compliance Is Not Enough: Getting the ethical culture right in your firm*.

A rather stark example of the FSA's approach in this area is the very recent final notice in relation to Citigroup Global Markets Ltd. Here, their controversial 'Dr Evil' strategy was regarded as a breach of Principles 2 and 3 and resulted in a penalty of just under £14m. In this instance, the individuals were not held personally culpable.

Whistleblowing

When a compliance culture breaks down, an individual employee may feel that they need to blow the whistle on their employer. A continuing risk for employees, especially compliance officers, is being put under pressure by senior management to act non-compliantly. Blowing the whistle, however, runs contrary to the duties of loyalty, confidentiality and trust and confidence owed by the employee to their employer.

Whistleblowing is recognised as a necessary evil and the Public Interest

Disclosure Act 1998 (PIDA) gives both employer and employee a framework in which they can operate without falling foul of employment law. The FSA has published guidance on PIDA, and how firms ought to put in place systems in order to address an employee's concerns which might lead to a PIDA action. Under PIDA any terms in a contract that attempt to gag a worker from making a "protected disclosure" will be void. A protected disclosure in an investment business is one when the worker reasonably believes that there is or is likely to be:

- a criminal offence
- a failure to comply with any legal obligation
- a miscarriage of justice
- risk to the health and safety of an individual



- damage to the environment
- deliberate concealment of the above.

The FSA's guidance encourages firms to blow the whistle internally. However, firms should also consider telling workers that they can blow the whistle directly to the FSA.

PIDA also provides protection for employers against vindictive employees. Disclosure will only protect an employee against adverse consequences, such as lack of promotion, pay rise or dismissal, if the employee:

- made the disclosure in good faith;
- reasonably believed the information; and
- did not act for a personal gain.

Employees will find it difficult to use PIDA as a shield during negotiations of termination of employment.

If an individual does blow the whistle

to the FSA, an employer may also face an FSA investigation which, even if the employer is found to be innocent, will take considerable time and money to sort out.

Employers and employees often find themselves on different sides of the fence, with employees caught between conflicting duties. The hope is that by creating a culture of compliance from senior management to clerks, both employer and employee will be on the same side of the fence when a regulatory issue arises and a need to blow the whistle will not occur. Such a culture should not be seen as a restriction on business, but as a pre-emptive move to save time and money that might otherwise be spent in correspondence with the FSA or in legal proceedings.

A culture of compliance is not based on a narrow-minded following of the FSA Handbook. Indeed, it is likely that many of those at the coal-face of the financial services industry will never open the Conduct of Business Rulebook. Instead, a culture of compliance stems from the seven principles for approved persons and the accompanying Code of Practice, both set out in the surprisingly short *Approved Persons' Rulebook*. If these principles are followed, companies will find themselves not only out of courts, but also out of the headlines.

This article is based on a lecture given by the authors on behalf of the SII on 10 November 2004.



More information

For more information, see the FSA's *Approved Persons' Rulebook*. Go to www.fsa.org.uk for details



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