

# New York University School of Law Program on Corporate Compliance and Enforcement

## Keynote Speech

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**Note:** this is the speech as drafted and may differ from delivered version.

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Thank you very much for inviting me here today. It is a great privilege to be here, listening to and participating in today's discussions. I congratulate the New York University Law School for convening today's program.

## Opening

Conduct issues give rise to competing tensions within firms. Everyone can feel hard done by, whether justifiably or not. Firms complain about having to shoulder responsibility for errant staff; staff complain about being scapegoated; regulators and other authorities are blamed for not holding to account those who are supposedly 'really responsible' with the public too often feeling the regulatory outcomes do not fully attribute blame. I want to speak to you about today's theme, the expanding scope of individual liability for corporate misconduct, from a UK perspective with reference to recent developments in the UK, especially the Senior Manager's Regime which commenced operation just over a year ago.

I want to explore this further as part of my general contention to you this afternoon that the Senior Managers and Certification Regime, to give it its full name, marks an important and decisive shift in the right direction in tackling these issues. But first let me explore with you the competing tensions.

## Responsibility 1

A number of years ago I ran a prosecution in Australia against a number of foreign exchange traders who had been charged with offences relating to what is known as 'rogue trading'. Their misconduct had caused substantial losses for their employer, a bank. At trial, the youngest of the traders decided to give evidence in his own defence. His counsel carefully took him through his evidence, seeking to establish that his client was young, naïve and had believed he was simply making profits for the bank, notwithstanding the fact some of these profits derived from wholly fictitious transactions and that he had followed instructions and directions from more senior people, some of whom had also been charged and were being tried in the same proceeding, but not all of them.

The witness box was on the right hand side of the court directly adjacent to the jury box and so, throughout his examination in chief, the young defendant had stared resolutely and directly at the jury, in particular, a juror sitting in the middle of the

jury box. The examination-in-chief was expertly conducted and began to reach its conclusion, with some crescendo, towards a final, crucial question,

'Now who do you say is responsible for the position you now find yourself in?' asked the wily defence counsel.

The defendant paused, just long enough for the judge and the prosecution team to sense the dramatic moment and for the court to fall completely silent.

'It was the bank's fault,' came the reply, in a very audible whisper, the kind of whisper that everyone in the court could hear as spoken out loud.

But the answer hadn't come from the defendant. Everyone turned to their left, to the jury member sitting in the middle of the jury box, who was now in tears. Before the defendant could add anything further, his counsel wrapped things up 'No further questions, Your Honour,' and sat down.

The fateful finger of accusation was pointing towards the bank and the verdict had been delivered, at least in a whisper and far earlier than anyone anticipated or, at least, on my side of the fence, had wanted. And of course we thought the case was lost.

## Responsibility 2

A different perspective, this time as told to me by a general counsel for a bank (and so it is hearsay and less reliable than the first story). It concerns a negotiation with a prosecuting authority (not in the UK). The bare bones of the case had been set out and serious discussions had commenced. Suddenly, the general counsel realised the essence of the case centred on the conduct of small group of employees and he had no idea who they were. 'Who are these people,' he growled, 'Give me their names so I can go back to the office, sack them straight away, so you can charge them.'

The fateful finger of accusation and summary justice once again, but this time pointing the other way.

## Responsibility 3

The third example is one that has been the subject of litigation in the UK over the past few years, culminating in a decision last week from the [UK Supreme Court](#) (link is external)<sup>[1]</sup>.

This issue concerned the London Whale trades that caused JP Morgan to suffer losses of over \$6 billion in 2012 as a result of highly risk trading and poor management of its synthetic credit portfolio in one of the its London based units.

The litigation concerned whether the senior manager, in this case, Mr Macris, should have been given procedural fairness by the Financial Services Authority, which was the predecessor of the FCA, when it published a Final Notice sanctioning JP Morgan. Mr Macris contended he was prejudicially identified in the Final Notice even though he was not named and, under UK rules, if he was prejudicially identified, then he was entitled to have been given a chance to contest the reference to him before the Final Notice was published. This had not happened.

Following the findings against JP Morgan, Mr Macris became the subject of separate proceedings which he vigorously contested. He ultimately accepted liability for certain failings but he succeeded in obtaining a ruling that, in one aspect, differed

substantially from findings, on the same issue, made by the FSA in relation to JP Morgan.

The case demonstrates how, in the clinches, the different perspectives of both the firm and an employee, Mr Macris in this case, are highly likely, if not inevitably, to be in conflict on crucial issues that affect one another's liability.

In practice these different perspectives on where blame and responsibility should rest also produce different attitudes towards litigation. Most firms have a commercial imperative to minimise harm to reputation and so a greater willingness to accept responsibility in order to do resolve public disputes as quickly as they can (something that I think regulators and law enforcement agencies should be careful not to exploit). Individuals, as we know, are more likely to fight which means different proceedings and hearings of the same evidence inevitably run the risk of different results.

From a broad, regulatory and law enforcement perspective, inconsistent verdicts and findings based on the same facts do not produce the best authority or precedent or clear bright lines for the rest of the market.

## Hard questions

These examples also demonstrate how the interests and fates of firms and individuals are also inter-connected. The interconnectivity means the investigator and the prosecutor need to be able to assess the conduct of all participants in the round and to avoid a piece-meal approach.

Finally, these three examples also demonstrate the question of firm or individual liability is not a simple binary either/or question of policy or attitude. Many other difficult questions need to be asked, dealing with:

- how the rules of attribution really operate i.e. how an individual's employee's conduct may or may not become the firm's
- the allocation of responsibility as between the firm and employees where the employee is acting or purports to be acting and believes he or she is acting within the scope of his or her duties and functions
- the manner and extent to which firm culture, especially governance rules, systems and processes, or their absence, affect conduct
- how responsibilities in fact have been allocated among employees, especially senior management
- the nature and limits of the rules, standards and obligations owed by an individual employee to the firm which, if breached, may trigger harm to the firm, including its customers and/or investors and whether an employee can ever owe wider obligations beyond those owed to the firm, perhaps even co-extensively with the obligations owed by the firm to the wider community

The last question is an important one because it is asking a more basic question. What kind of wrong is committed by firms and what kind of wrong is committed by individuals? Are they different, mutually exclusive or co-relatives of one another?

## Individual and firm liability: co-relatives?

Corporate fiduciary duties of care and diligence imposed on company directors are probably the closest statutory precedent for senior management liability. However, duties owed by company directors and officers are primarily owed to the company and are generally only enforceable by the company. Moreover, they do not necessarily mean the company itself has committed any breach or wrong. The company is more or less the victim, certainly the primary victim.

If we take William Blackstone's distinction between private and public wrongs as a general guide<sup>[2]</sup>, a wrong committed by a company director arguably sits closer, on the spectrum, to a private rather than to a public wrong at least in jurisdictions like the UK where such duties are not generally enforceable by public authorities (keeping in view Blackstone's public wrongs are those that violate public rights which affect the whole community 'considered as a community'<sup>[3]</sup> by which Blackstone meant the public interest or the community as the embodiment of all of us to whom public duties are owed).

Part of the challenge here is that there is a public perception that individual misconduct within a firm, at least serious misconduct, is, in fact, more than a private wrong, affecting more than just the firm or other employees and often involving a public wrong in the sense that because it involves the violation of a public right, against the community 'considered as a community' (as Blackstone put it)<sup>[4]</sup>.

The Senior Manager's Regime, I think, marks a distinct and positive turning point

The Senior Manager's Regime, I think, marks a distinct and positive turning point here because it provides a clear framework in which the responsibilities of senior managers are identified and allocated. This serves to answer one aspect of the problem that existed before insofar as there was a perception the legal framework around these questions was inadequate.

But I think the Senior Managers Regime provides more than a legal framework.

## The Senior Managers Regime

The Senior Manager's Regime helps to align the responsibilities of key senior managers to those that are owed by the firm more generally to the whole community. In this sense, the obligations of senior managers, owed to the firm, can only be understood properly by reference to their co-relative, namely the obligations owed by the firm itself to the community. A failure at senior manager level becomes one that is more likely to affect others beyond the firm, either through the imposition of financial harm or damage or affecting trust and confidence in our markets i.e. management misconduct begins to resemble the kinds of public wrongs that may affect the whole community 'considered as a community' which means, in turn, a greater expectation that such wrongs will be dealt with as public wrongs as well. The Senior Managers regime responds to the public perception that individual liability often gives rise to more serious consequences, affecting not only trust and confidence in our markets, but also the integrity of public rights and expectations and the well-being of customers, in other words, the community 'considered as a community'.

The Senior Managers Regime was the result of recommendations by the UK Parliamentary Commission on Banking Standards which recommended there be introduced a regime that would provide greater precision about the individual responsibilities of senior managers and serve as a foundation for changes to the way in which those responsibilities might be enforced.

The overriding purpose of the regime is to improve genuine accountability in firms

The overriding purpose of the regime is to improve genuine accountability in firms by removing ambiguous or bureaucratic structures that have impeded or obfuscated clear lines of responsibility.

The regime designates specified senior management functions all of which need to be mapped across the organisation and performed by specified senior managers.

The essence of the regime is a statutory provision created by the Bank of England and Financial Services Act 2016 which created what is called the duty of responsibility. The duty of responsibility imposes an obligation on senior managers to take such steps as a person in their position could reasonably be expected to take to avoid the firm from contravening a relevant requirement.

It is the first statutory duty of its kind and it is significant for that fact alone because previously conduct rules for senior management were the result of regulatory rather than parliamentary processes.

In enforcing this duty, the FCA must establish, first that the firm committed a relevant contravention of our requirements; secondly that the defendant was the senior person responsible for the activities in question and thirdly the defendant failed to take such reasonable steps to avoid or prevent the firm from contravening.

While the FCA's Handbook included conduct rules for individuals in authorised firms, the key difference under the Senior Manager's Regime is that specific senior management responsibilities have now been mapped to identify individuals within firms, with statements of responsibility which make it clear what each senior manager, in fact, has responsibility for.

The regime is also supported by conduct rules that apply to all staff in the firm and employees who undertake roles which could pose a risk of significant harm to the firm or its customers are also required to be certified by the firm as fit and proper.

I want to make four practical observations about the Senior Manager's Regime.

First, the duty of responsibility does not create a separate and independent basis for senior management liability. A senior manager's liability, under the duty of responsibility, depends on the firm's wrongdoing because it is, in essence, a duty to act reasonably as a manager to prevent the firm from contravening a relevant requirement. This means any action involving the duty of responsibility will give rise to a need consider whether action needs to be taken against the firm as well as against the senior manager.

Secondly, a senior manager is not liable just because the firm has breached a requirement. The senior manager's liability arises because he or she has failed to take reasonable steps to prevent the firm from being in breach and the firm is in breach.

In other words, the regime is not intended to make senior managers vicariously or strictly liable for misconduct that occurs within or by the firm. The senior manager is not a proxy or a scapegoat for the firm or anyone else.

Thirdly, the requirement to prove a failure to take reasonable steps will no doubt invite arguments that the management failure must have caused the firm to be in breach. I see an argument the other way of course as well. By the same token, the relevant breach by the senior manager must be one where it can be said the management failure is a factor in the corporate breach.

Fourthly, the relevant duty applies not only to acts but also to omissions. Accordingly, a failure to act, which may include a failure to know what a senior manager ought reasonably to be cognisant of, may be enough to constitute a breach.

The Senior Managers Regime marks a decisive and positive shift in the on-going challenge to improve not only firm behaviour but also how those entrusted with senior management responsibilities perceive the nature of those obligations and the consequences when they are not met.

## The double view

Let me now say something about corporate misconduct because some have viewed the Senior Managers' Regime as a means of shifting corporate liability onto individuals. This is not the case, so far as the duty of responsibility imposed on senior management is concerned, because the firm's liability is a jurisdictional fact in any action against an individual.

There is no free pass for firms and so the Senior Managers Regime does not mean there will be an end to action against firms, including heavy financial penalties.

One of the challenges of conduct regulation is to recognise squarely that not all misconduct can be prevented

Financial penalties, of course, are not the sole means of holding firms to account. One of the challenges of conduct regulation is to recognise squarely that not all misconduct can be prevented so we need better ways to detect, get to the bottom of and, in this context, to regulate its remediation. Remediation here involves not only improving the systems and processes to insure the future. In addition to appropriate sanctions, remediation here includes looking back and identifying properly the consequences of misconduct and making sure there is just reparation for the harm and damage caused to third parties, as far as can be practically achieved within the scope of our powers and functions.

This week [we took action against Tesco plc](#), a listed company in the UK. We found that Tesco Plc and one of its subsidiaries committed what is known as market abuse in relation to a trading update published on 29 August 2014, which gave a false or misleading impression as to Tesco's publicly traded shares and bonds, inflating their price. We decided not to impose a sanction. There are several reasons for this: the company has been fully cooperative and has agreed to accept our findings; at the same time, the subsidiary company, Tesco Stores, has agreed in principle a deferred prosecution agreement (DPA) with the UK Serious Fraud Office in relation a finding of false accounting. Tesco Stores has agreed also to certain undertakings as part of the DPA, which remains subject to Court approval, including the payment of a fine in the sum of £129 million<sup>[5]</sup>.

More fundamentally and more significantly, the company has accepted an order to pay compensation to those investors who purchased shares and bonds following the announcement of the misleading profit forecast and before its correction by the company, a few weeks later. This kind of compensation order has not been made before and is designed to provide compensation to investors who were net purchasers during the period. The measure of damages is not the full price of the securities that were purchased because Tesco did not necessarily cause the investors to purchase them. The measure of damages is the difference between the actual price of the securities and the price they would have traded if the false information had not been published.

The company's decision to co-operate with us and to accept not only our findings but also not to contest the first compensation order sets a strong example of corporate responsibility. A firm's response to discovering wrongdoing in its affairs is perhaps the best test of its integrity. This is a test that Tesco has passed.

While this is the first time the FCA has taken this kind of action, there is nothing unique or novel about the principles here. It is in fact a very Blackstonian outcome because it accords with his conception of the 'double view' where violations of public wrongs damage not just the conceptual community but also individuals, in this case to a very large number of individuals who were participating in good faith in a public market for securities. They now have the opportunity to be compensated.

And so while it is good to pay attention to the liability of individuals for corporate misconduct, we should not forget the need for all wrongdoers to account to those individuals who otherwise end up paying – unfairly - for the consequences of wrongdoing.

## Conclusion

Let me conclude with a short codicil and update you on the young trader who appeared to be acquitted by the jury member who answered 'It's the bank's fault' to the question who should the young man blame for the position he found himself in.

A few days later, the defence case closed and jury, as they say, went out and eventually came back with the verdict. As they shuffled back into the jury box, the same juror was in tears again. The foreman stood to announce the verdict. But this time the verdict was reversed. The young man was found guilty and duly convicted and sentenced to a term of imprisonment.

There is a final lesson here for us regulators, perhaps the most important lesson of all. Responsibility for corporate misconduct isn't a matter of emotions, let alone policy, doctrine or philosophy. Instead we should follow the example of this juror who paid close attention to and followed the evidence (and perhaps her conscience) to its logical and rational conclusion.

## Footnotes

1. <sup>^</sup> *Financial Conduct Authority v Macris* [2017] UKSC 17 (Lord Sumption, Lord Neuberger, Lord Hodge, Lord Mance, Lord Wilson)
2. <sup>^</sup> *"The distinction of public wrongs from private, of crimes and misdemeanours from civil injuries, seems principally to consist in this: that private, or civil injuries, are an infringement or privation of the civil rights which belong to individuals, considered merely as individuals; wrongs, or crime and misdemeanours, are a breach and violation of the public rights and duties, due to the whole community, considered as community, in its social aggregate capacity."* *Commentaries on the Laws of England*, (1765-69), William Blackstone, Book IV, Chapter 1.
3. <sup>^</sup> *Ibid.*
4. <sup>^</sup> *Ibid.*
5. <sup>^</sup> *The Serious Fraud Office has instituted criminal proceedings in relation to other persons in respect of the issues that are the subject of the DPA. The*

*DPA concerns only the potential criminal liability of Tesco Stores Limited and does not address whether liability of any sort attaches to Tesco plc or any employee or agent of Tesco plc or Tesco Stores Limited. The FCA's findings in relation to market abuse by Tesco Plc. are made in the context of the specific requirements of the Financial Services and Markets Act 2000 and are not findings of criminal misconduct. The FCA makes no findings on whether a criminal offence has or may have been committed by any person.*