

ALLEN & OVERY

The Manager-in-Charge Regime: Ruffling feathers in the year of the Rooster?

Augmenting or extending senior management accountability?

INTRODUCTION

Senior management accountability has been a priority of global financial services conduct regulators in recent years.

One need only look to a speech on 19 January 2017 by Mark Steward, director of enforcement and market oversight of the UK Financial Conduct Authority (**FCA**), when he declared that “*senior managers ought to be responsible for happens on his or her watch. That’s what shareholders, consumers and the FCA want.*” Closer to home, on the same day, Julia Leung, Executive Director, Intermediaries of the Securities and Futures Commission (**SFC**) delivered a keynote address to the AIMA APAC Annual Forum 2016 in Hong Kong in which she highlighted the SFC’s Manager-in-Charge initiative (**MIC Regime**) and the SFC’s intention to heighten the accountability of senior management. The SFC considers it important to “*foster a sense of genuine responsibility and clear accountability*” in senior managers of licensed corporations.

But what does that mean in practice? And does the MIC Regime augment or actually extend senior management accountability?

This bulletin is part of a series on the MIC Regime, in which we discuss potential liabilities for manager-in-charge (**MIC**) and senior management and some key mitigation measures.

SUMMARY OF THE MIC REGIME

The MIC Regime was introduced in a [SFC circular](#) in December 2016¹ (**Circular**). It has been introduced to enhance, adapt, and supplement existing arrangements for senior managers in licensed corporations, and signals an increasing focus by the SFC on the role played by, and the accountability of, senior management.

The Circular attempts to “clarify” the SFC’s expectations as to the management and oversight of licensed corporations. Pursuant to the Circular, licensed corporations will need to nominate at least one MIC for each of eight designated “core functions”, including the licensed corporation’s key business lines, comprising each of the activities for which the licensed corporation is licensed by the SFC, operational controls, risk management, and compliance.

The licensed corporation will also be required to submit to the SFC certain basic information about each of its MICs, as well as an organisational chart depicting its management and governance structure, business and operational units, and reporting lines. In addition, the licensed corporation will be required to submit a form which certifies that each of the MICs has been informed of and acknowledges his/her appointment as a MIC and the Core Function(s) for which he/she is principally responsible.

The SFC intends to commence collecting management structure information from licensed corporations on 18 April 2017, and expects all existing licensed corporations to have submitted their management structure information on or before 17 July 2017.

¹ Circular to Licensed Corporations for Augmenting the Accountability of Senior Management, 16 December 2016.

For an **overview** and discussion of the **MIC Regime** requirements, please see our bulletin "*The Manager-in-Charge Regime: An Overview*" available [here](#).

BUT WHAT DOES THAT MEAN FOR SENIOR MANAGEMENT ACCOUNTABILITY?

AUGMENTING OR EXTENDING SENIOR MANAGEMENT ACCOUNTABILITY?

The legal test by which senior management may be subject to sanction under the Securities and Futures Ordinance (SFO) has not changed following the introduction of the MIC Regime.

Under the SFO, a "regulated person" will be exposed to disciplinary consequences where they are guilty of misconduct.² "Regulated person" means a person who is licensed by the SFC, a responsible officer (**RO**), or a person involved in the management of the business of a licensed corporation. For this purpose, "misconduct" includes contraventions of the provisions of the SFO and breaches of the conditions of any licence issued to the individual by the SFC (for example, the fitness and properness requirements imposed on persons who are licensed by the SFC).

Personal liability of individuals who are involved in the management of a licensed corporation can also extend to liability for acts committed by others. Under the SFO, where a licensed corporation is guilty of misconduct as a result of the commission of any conduct attributable to any neglect on the part of a person involved in the management of the licensed corporation, that person is also guilty of misconduct.³

Whether a person is a "regulated person" due to being involved in the management of the business of a licensed corporation is a question of fact taking into account their role and responsibilities within the licensed corporation, to be determined (ultimately) by the courts. However, although the MIC Regime does not alter the legal test by which sanctions can be imposed, it does appear (at least so far as concerns the SFC) to extend the prospect of personal liability to all persons designated as MICs as being persons "involved in the management of a licensed corporation".

WHAT ARE THE RESPONSIBILITIES OF SENIOR MANAGEMENT OF LICENSED CORPORATIONS?

The senior management of licensed corporations have a number of broad responsibilities, many of which were identified by the SFC in the Circular. These include:

- responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the corporation;⁴
- management of the risks associated with the business of the corporation, including performing periodic evaluation of its risk management processes;⁵
- responsibility for the adequacy and effectiveness of the internal control system implemented, which systems must establish and maintain:
 - policies and procedures to ensure the firm's compliance with all applicable legal and regulatory requirements as well as with the firm's own internal policies and procedures; and
 - effective policies, operational procedures controls which will be evaluated in light of whether they serve to ensure (among other things) the integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner.⁶

DOES THE MIC REGIME MEAN THERE IS A GREATER RISK THAT THE SFC TAKES ACTION AGAINST THOSE INVOLVED IN MANAGEMENT?

Not necessarily, but in our view this seems likely.

First, doing so would be consistent with the priorities set by the SFC and other regulators of ensuring genuine responsibility of and clear accountability for senior management.

² Section 194 of the SFO.

³ Section 193(2) of the SFO.

⁴ General Principle 9 of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).

⁵ Paragraph 14.1 of the Code of Conduct.

⁶ Internal Control Guidelines for Persons Licensed by or Registered with the SFC, Sections V and VII.

Second, under the MIC Regime, a licensed corporation is required to provide the SFC with the names and responsibilities of each MIC. This will provide an easy means for the SFC to identify who is responsible for the management of the Core Function in which misconduct may have occurred.

Third, each licensed corporation is required to certify that each individual MIC has been informed of and acknowledges (a) his/her appointment as a MIC and (b) the particular Core Function(s) for which he/she is principally responsible. This will make it difficult for an individual MIC to later say he/she was not properly appointed or was not in reality involved in the management of the licensed corporation.

Accordingly, those who are designated as MICs will wish to keep in mind the legal basis by which they could be deemed responsible for the conduct of others within their Core Function(s).

DOES THAT REMAIN THE CASE FOR MICS DOMICILED ABROAD?

In short, yes. The SFC clearly stated in its FAQs to the Circular that the disciplinary powers under the SFO apply to all regulated persons and do not differentiate between regulated persons located in Hong Kong and those located outside. In fact, the SFC has in the past taken disciplinary action under section 194 of the SFO against a RO and director for failure to take part in the management of the relevant licensed corporation after the director had left Hong Kong.⁷ The SFC found that the director had been equally responsible for the licensed corporation's failings because he had not actively participated in, and taken care and diligence in, the licensed corporation's management. The SFC banned him from re-entering the industry for life. We do not anticipate that this approach will change.

WHAT IN PRACTICE SHOULD A PROSPECTIVE MIC DO TO HELP DEMONSTRATE FULFILMENT OF THEIR OBLIGATIONS AND RESPONSIBILITIES?

There are a number of practical steps a prospective MIC could take to both prepare for the role and also demonstrate compliance with the SFC's regulatory obligations.

PREPARATION FOR THE MIC ROLE

A MIC is expected to understand the Core Function for which he/she is responsible. Those about to take on new responsibilities as an MIC should consider what they need to do to fulfil that obligation – review handover notes, hold meetings with relevant reports/stakeholders, understand applicable governance and risk management frameworks as well as systems and controls, review risk thresholds and appetites as well as risk assessments, and understand the key regulatory requirements that apply to the particular core function.

Given the risk of personal sanction for any misconduct that may occur within the Core Function(s) for which a MIC is responsible, the MIC may also wish to undertake a pre-appointment risk assessment⁸ – consider:

- what risks arise in the core function for which he or she may be responsible;
- how are those risks assessed and monitored;
- what improvements could be made to the systems and controls to better address those risks; and
- how should the implementation of those improvements be monitored and by when must they be in place.

A MIC should discuss such issues with relevant members of the Core Function for which he/she is or will be responsible and other Core Functions that may have an impact on the control environment such as Risk Management, Information Technology, Compliance, and Operational Control and Review.

Overall, MICs should take time prior to the commencement of the MIC Regime to familiarise themselves with the structure of their Core Function(s), reporting lines, key personnel, policies, and procedures. This process will serve to identify any problems prior to assuming responsibility as MIC of that function so that there are no surprises after the MIC Regime takes effect.

⁷ Statement of Disciplinary Action against Roger Albert John and Hamish Gordon Cruden, 14 October 2014.

⁸ In England and Wales, the (former) Financial Services Authority (FSA) has in the past taken personal action under the Approved Persons Regime for alleged failure to take reasonable steps to ensure that the business of a firm complied with the relevant requirements and standards of the regulatory system, then known as Statement of Principle 7 (SPR7). Specifically, the FSA alleged that Mr John Pottage had failed to take reasonable steps to identify and remediate alleged serious flaws in the design and operational effectiveness of the relevant governance and risk management systems and to undertake a "bottom-up" review of systems and controls sooner than he did. The FSA's decision and financial penalty for breach of SPR7 was however overturned on appeal by the Upper Tribunal in 2012 after a careful factual analysis.

DECISION MAKING, DELEGATION AND COMMITTEES

One of the overarching considerations a MIC must have is the process by which he/she reaches his/her decisions. Some decisions will be taken by the MIC himself/herself, or with a small group of others. In those circumstances, a MIC should consider whether he/she needs expert advice and the adequacy of the management information provided on which the decision should be made.

Other decisions will be taken by a MIC as part of a committee (in its FAQ on the Circular, the SFC has recognised that committees may have management responsibility within one of the eight Core Functions identified in the regime). When considering whether a decision should be taken by a committee, a MIC should consider the objectives and terms of reference of committees included in the licensed corporation's governance arrangements, but also whether the committee in question is a decision making forum or a consultative forum, and if it is a decision making forum, whether collective decision making is appropriate and reasonable for the decision to be made.

While the SFC accepted in its soft consultation for the MIC Regime that some licensed corporations may need to delegate responsibility for certain Core Function(s) to third parties (e.g. IT), it did so while noting that a MIC should be responsible for supervising the outsourced function. If responsibilities are to be delegated, a MIC should therefore consider to whom responsibility would be delegated and how that issue is best decided, as well as ensuring that adequate oversight and control is maintained over the chosen delegate.

PREPARATION, PREPARATION, PREPARATION

The above steps are not exhaustive. MICs should also consider how best they could promote “good” culture, robustly monitor risks, and manage specific issues such as a change in business strategy. To those prospective MICs who are already ROs engaged in, and with detailed knowledge of, the particular Core Function(s) for which they are or will be responsible, such issues are likely to be at the forefront of their minds already. For prospective MICs who would be new to this title, time would be well spent considering how best to prepare for the regulatory obligations that will follow.

For a discussion of the **practical considerations for licensed corporations** when preparing for the MIC Regime, please see our bulletin “*The Manager-in-Charge Regime: Practical considerations for licensed corporations*” available [here](#).

If you would like further information about how Allen & Overy can assist your firm in relation to the MIC Regime, please do not hesitate to contact us.

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