

FINANCIAL REGULATION & INVESTIGATIONS

First Enforcement Action for breach of UK Senior Manager Conduct Rules

On 13 April 2023, the UK's Prudential Regulation Authority (PRA) imposed a financial penalty of £81,620 on an individual for failing to comply with a Senior Manager Conduct Rule under the UK's Senior Managers and Certification Regime (SMCR).

This is the first enforcement action in the UK against a Senior Manager for a breach of the UK Senior Manager Conduct Rules (UK Conduct Rules). We discuss this decision and the potential read-across to the Central Bank of Ireland's (Central Bank) Individual Accountability Framework (IAF) and Senior Executive Accountability Regime (SEAR) in this article.

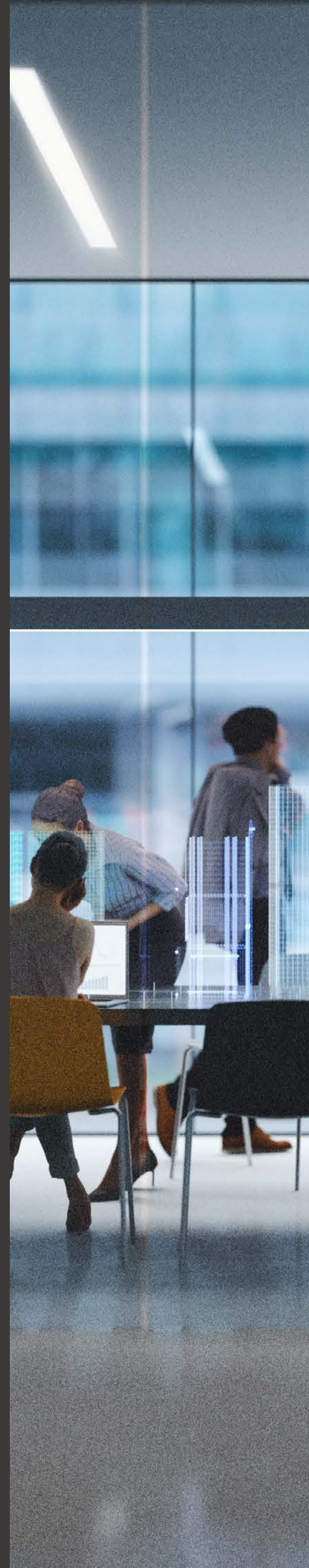
6 MIN READ

Background to the Enforcement Action

The relevant individual was the Chief Information Officer (CIO) of TSB Bank plc (TSB) in 2018, when a planned migration of information technology (IT) services to a new IT platform resulted in significant disruption to the continuity of TSB's provision of core banking functions. This disruption affected branch, telephone, online and mobile banking with some issues persisting for a sustained period of months involving a significant proportion of customers. The [Financial Conduct Authority \(FCA\)](#) and the [PRA](#) have already fined TSB £48.65m in total for breaches arising from this disruption.

The planned migration of IT services arose in the context of a takeover bid from Sabadell, a Spanish bank, and a decision by TSB to migrate its IT services from its existing IT platform to a new, purpose built UK version of Sabadell's IT platform. To do so, TSB entered into an outsourcing arrangement with Sabadell's IT service subsidiaries (**Service Provider**) to design, build and operate the new IT platform. The Service Provider in turn engaged third party service providers to deliver systems and services required for the new IT platform and the migration.

In the weeks leading up to the migration, TSB sought formal assurances from the Service Provider as to readiness to proceed with the migration and operation of the new IT platform. In particular, TSB obtained written confirmation from the Service Provider as to the migration readiness of the new platform, which referred to confirmations of readiness received, or anticipated, from critical fourth party suppliers (**Service Provider Confirmation**). Separately, the relevant individual provided a CIO attestation to the Board recommending to proceed with the migration. This attestation asserted: (a) the Service Provider was ready to proceed, without any further explanation, and (b) his own satisfaction that the Service Provider Confirmation could be relied upon.



Application of the SMCR

The PRA reviewed the relevant individual's Statement of Responsibilities under the SMCR alongside TSB's Material Risk Register. They identified that:

- at the time of the disruption the relevant individual was, as CIO, responsible for TSB's IT and IT business continuity planning and for TSB's performance of its obligations under the PRA's Outsourcing Rules
- this responsibility was split with another Senior Manager. Under that arrangement, the relevant individual was specifically responsible for the key outsourcing relationship with the Service Provider
- the relevant individual was also owner of the material risk that 'migration causes operational instability or a degradation in resilience and poor customer outcomes'

The relevant individual also held Senior Manager Function (**SMF**) 18 'Other Overall Responsibility' (which applies where a senior executive is the most senior person responsible for an area of the firm's business but they do not perform any other SMF). There is no equivalent Pre-Approval Controlled Function (**PCF**) for 'Other Overall Responsibility' under the IAF in Ireland, although in October 2020 the Central Bank introduced PCF49 CIO, which appears to be its nearest equivalent.

Separately, the relevant individual was also subject to the UK Conduct Rules, which apply to individuals performing SMFs. In particular, the individual was subject to UK Conduct Rule 2, which provides that 'you must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system'.

Key PRA findings

The PRA focused on the relevant UK Conduct Rules, rather than the duty of responsibility arising from the scope of the relevant individual's SMF responsibility.

Specifically, the PRA found that the relevant individual breached UK Conduct Rule 2 because he failed to take reasonable steps to ensure that TSB complied with the PRA's Outsourcing Rules, in adequately managing and appropriately supervising its outsourcing arrangement with the Service Provider. In particular, they noted that he failed to ensure that he or his CIO team obtained sufficient assurance from the Service Provider in relation to its readiness to operate the new IT platform. It was noted that these failings undermined TSB's operational resilience and contributed to the significant disruption TSB experienced to the provision of critical functions, potentially impacting on financial stability.



Read-across to the IAF and SEAR in Ireland

The wording of the UK Conduct Rules aligns with the Additional Conduct Standards under the IAF. In particular, UK Conduct Rule 2 closely aligns with the second Additional Conduct Standard, which requires PCF and controlled function (CF) 1 role holders to take reasonable steps to *'ensure that the business of the RFSP is conducted in accordance with its obligations under financial services legislation'*.

Whilst guidance from this action is not directly applicable in Ireland, it is of considerable interest given the particular alignment between UK Conduct Standard 2 and the second Additional Conduct Standard. It is particularly useful in the context of a Senior Manager (PCF/CF1 role holder) seeking to rely upon the capabilities of, and confirmations from, outsourced entities.

'Reasonable steps'

This enforcement action provides some guidance on the concept of 'reasonable steps' under the UK Conduct Rules, and the PRA's expectation that the relevant individual, as a Senior manager, would take reasonable steps to ensure that the business of TSB, for which he was responsible, complied with relevant regulatory requirements and standards.

Verification of information

The PRA found that:

- the Service Provider Confirmation, which included confirmations from critical fourth parties, were to some extent, *'forward looking statements of good intention or expectations rather than statements of fact about the completeness of readiness activities already undertaken'*
- the relevant individual relied upon the critical fourth party confirmations without verifying whether the Service Provider had actually critically assessed these. In this context, the relevant individual was over-reliant on the fact that the fourth parties were engaged by the Service Provider under contracts which conformed with the PRA's Outsourcing Rules

- the relevant individual did not give sufficient consideration to the appropriateness of relying on the Service Provider Confirmation without further investigation or challenge and was indeed over-reliant on that confirmation

Practical lessons relevant to the IAF:

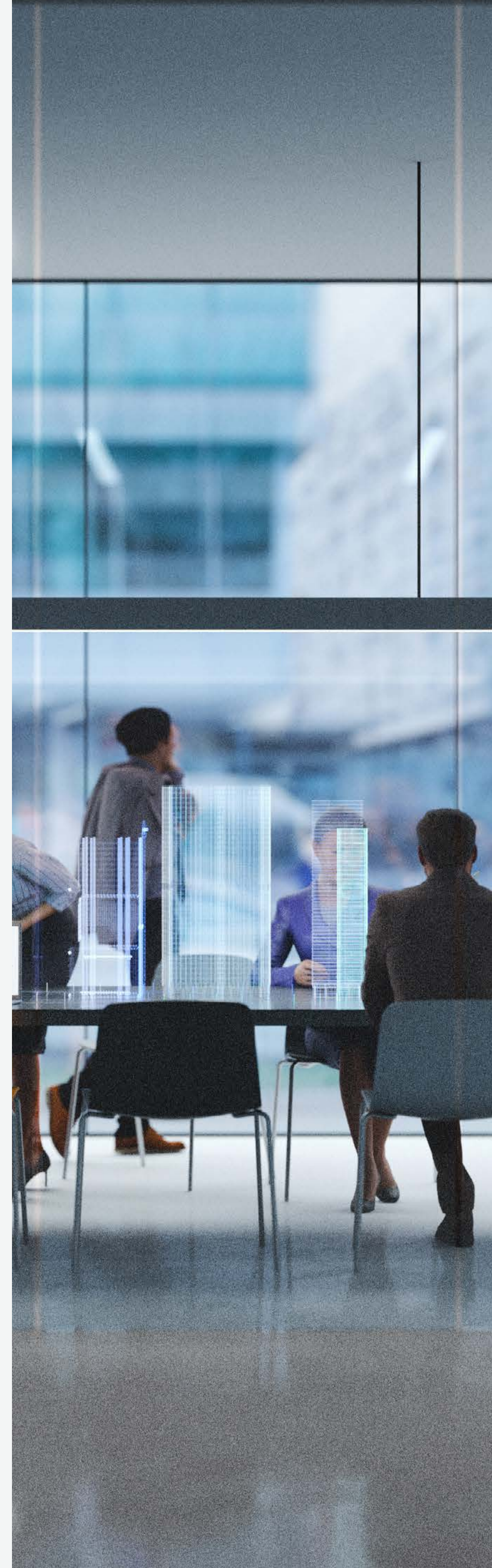
- It is important that senior executives who are PCFs or CF1s appropriately verify/challenge confirmations received from third/fourth parties and not be over-reliant on such confirmations 'on their face'
- Where a firm is reliant on an outsourced service provider to manage underlying 'fourth parties', a sufficiently engaged and proactive approach to the practical oversight of the outsourced provider is required – beyond merely having in place the appropriate contractual framework - to ensure that the firm's interests and needs are met

Board information

The PRA was critical of the relevant individual's CIO attestation referring to the Service Provider Confirmation in a single paragraph because it did not annex the letter of confirmation received from the Service Provider itself. Nor was the letter included in any of the papers for the Board.

Practical lessons relevant to the IAF:

- Noting the importance of senior executives, who are PCFs or CF1s, adequately substantiating any assurances they give to the Board and, where necessary, providing the Board or relevant governance forum with appropriate underlying information to ensure they are fully informed as to the basis of attestations and/or the risks involved in proceeding with, and implications of, a decision to proceed with a project



Ongoing monitoring and oversight

The PRA found that the relevant individual failed to ensure that TSB formally and adequately reassessed the Service Provider's capabilities on an ongoing basis, and failed to take a holistic view of the risks associated with the migration. This need for adopting a holistic view and for ongoing reassessment was heightened by IT problems experienced in the run up to the migration, and the nature of the outsourcing arrangement with the Service Provider, which provided TSB with limited visibility over the risks associated with fourth parties.

Practical lessons relevant to the IAF:

- The importance of senior executives who are PCFs or CF1s maintaining effective oversight of any outsourcing arrangements and considering which factors may warrant closer oversight. This can include understanding and probing service level breaches
- In this case, there were particular problems experienced in certain 'governed transition events' in the months leading up to the migration, which arguably should have required further investigation or consideration by the relevant individual
- Regulatory expectations that firms (and senior executives) must have visibility of outsourcing or supply chains and must consider whether extensive outsourcing could compromise their ability to oversee and monitor an outsourcing arrangement in practice

Regulator's reliance on Statements of Responsibilities

It is clear from this action that the PRA placed considerable reliance on key documentation under the UK's SMCR in determining where responsibility for this contravention lay. In particular, the PRA relied upon the individual's Statement of Responsibilities and the firm's Material Risk Register.

Practical lessons relevant to the IAF:

- With the introduction of Statements of Responsibilities and Management Responsibilities Maps under SEAR, it is important for Senior Managers to be cognisant of their responsibilities under this documentation and to ensure that they are taking 'reasonable steps' to meet these responsibilities
- In Ireland, the Central Bank has been clear that it will, if necessary, look behind Statements of Responsibilities and consider 'substance over form' when determining who was the responsible executive for any particular failure at any point in time. It is therefore important to continually assess an executive's Statement of Responsibility against the 'real life' scope of their responsibilities within the firm's business

Responsibility sharing

The PRA found that the relevant individual was responsible for TSB's performance of its obligations under the PRA's Outsourcing Rules and that this responsibility was split with another Senior Manager. However, the PRA is clear that it was he who had responsibility for TSB's outsourcing arrangement with the Service Provider, rather than the other Senior Manager with whom he shared this responsibility. Unfortunately, no further detail is given as to how the PRA made this determination and no further clarity is given on the sharing of joint responsibilities.

Practical lessons relevant to the IAF:

- In its recently issued consultation on key aspects of implementation of the IAF (Consultation), the Central Bank clarifies that sharing or splitting of responsibilities is not permitted under SEAR, other than in the case of job sharing
- The Central Bank further clarifies that each job sharing individual will have full accountability for the relevant responsibility. However, when considering 'reasonable steps' to discharge the responsibility, the Central Bank will 'have regard to the manner in which activities and tasks were shared amongst the job sharers, and their completion of tasks on that basis'
- This proposed approach appears to align with that of the PRA in this action; however, further clarification would be welcomed as to how this assessment will be undertaken in practice

Outsourcing expectations

This enforcement action also included a number of instructive expectations of UK firms with respect to outsourcing arrangements, whether external or intra-group. In particular, the PRA's action emphasises the broad

expectations on firms (and Senior Managers) to ensure compliance with regulatory requirements in respect of outsourcing. In Ireland, these requirements are reflected in relevant guidance at both EU level and in the Central Bank's own Cross-Industry Guidance on Outsourcing.

Practical lessons relevant to the IAF:

- The Central Bank's Consultation confirms that, where outsourcing arrangements are in place, there must be a PCF role-holder in the regulated firm with responsibility for outsourcing arrangements. In addition, where there is outsourcing of a PCF role, the role holder should fall under the oversight of a PCF role holder within the entity
- The Central Bank's Consultation is also clear that a PCF role holder must be allocated 'PR21' ('developing structures and mechanisms to oversee, monitor and assess the appropriateness and performance of the firm's outsourcing frameworks including outsourcing arrangements and associated outsourcing risks'). The balance and roles of responsibilities in overseeing activities will need to be carefully allocated and documented as between the PCF allocated with the proposed prescribed responsibility 'PR21', and the PCF whose role and responsibilities are directly related to, or impacted by, the specific services that are actually being outsourced (if these are different individuals in any particular firm)
- This analysis may be particularly complex for group structures under which 'service companies' provide varied services to other regulated entities within the group under single contractual and governance arrangements
- The references to practical oversight of outsourced services also emphasises the importance for firms to ensure that they have escalation and reporting structures in place to feed into any outsourcing governance committee and ensure that membership, reporting executives and the Chair of relevant outsourcing fora are appropriately defined

Enforcement approach

It is of note that, despite holding the SMF 18 responsibility under the UK SMCR, the PRA pursued the relevant individual for a contravention of UK Conduct Rule 2, rather than for breach of the 'duty of responsibility' in respect of this SMF. This demonstrates the effectiveness of the UK Conduct Rules as an enforcement tool in ensuring individual accountability for regulatory breaches by firms.

Practical lessons relevant to the IAF:

- As set out above, UK Conduct Rule 2 aligns with the second Additional Conduct Standard, which applies not only to PCF role holders in firms within the initial scope of SEAR, but to all PCF and CF1 role holders in all regulated firms. The Central Bank's Consultation indicates that this requirement will take effect from 31 December 2023
- It is also noteworthy that the PRA's decision expressly refers to the importance of operational resilience and the fact that the PRA placed high priority on embedding operational resilience in its supervisory approach to mitigate the risks of disruptions, such as those occurring during this migration. It therefore appears that the enforcement action was taken at least in part because this incident fell clearly within the scope of the UK regulator's supervisory priorities at the time



Next steps

This action provides instructive guidance on regulatory expectations with respect to outsourcing and, in particular, reasonable steps in the context of a senior executive (PCF/CF1 role holder) seeking to rely upon the capabilities of, and confirmations from, outsourced entities. It also emphasises the importance of firms' facilitating and supporting PCF and CF1 role holders in their compliance with the Additional Conduct Standards.

Visit our [Individual Accountability Framework website](#) for further materials, including our '[ALG Guide to the IAF and SEAR](#)' and our '[ALG Guide to Central Bank Consultation and draft Guidance](#)', together with thought leadership on this important topic.

Your SEAR team

For further information on the Individual Accountability Framework and SEAR, and how ALG can assist your business, please contact :

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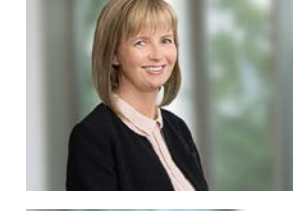


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