

Industry Codes of Conduct and Feedback on FCA Principle 5

Policy Statement

PS18/18

July 2018



This relates to

Consultation Paper 17/37
which is available on our website at
www.fca.org.uk/publications

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1 Summary

- 1.1** In November 2017 we published CP17/37¹ 'Consultation Paper on Industry Codes of Conduct and Discussion Paper on FCA Principle 5'.
- 1.2** This Policy Statement (PS) summarises the feedback received on this consultation. We outline our final policy and Handbook amendments on the FCA's approach to the recognition of codes of conduct in unregulated markets, including the process and criteria for doing so, for the purposes of the Senior Managers & Certification Regime (SM&CR).
- 1.3** We also summarise feedback received on the discussion chapter of CP17/37 which looked at extending the application of Principle 5 of the FCA's Principles for Businesses, so that authorised firms would be required to observe proper standards of market conduct for their unregulated activities.

Who this affects

- 1.4** This policy statement will be of interest to authorised firms currently subject to the SM&CR, including banks, building societies, credit unions and dual-regulated investment firms.
- 1.5** In addition, all FSMA authorised firms will be affected by the policy detailed in this PS when the SM&CR is extended to insurers and FCA-solo authorised firms. This is planned for 10 December 2018 for insurers and 9 December 2019 for solo-regulated firms.
- 1.6** Consumers, both private individuals and companies, using authorised firms' services that are 'unregulated activities' may be interested in our final rules and approach as they will benefit from authorised firms observing proper standards of market conduct.

Context

- 1.7** The Fair and Effective Market Review (FEMR) of UK fixed income, currency and commodity markets was conducted in 2014/15 after the revelations of extensive misconduct in FX markets and in submissions to the LIBOR benchmark. Among the recommendations of the three FEMR authorities (the FCA, Bank of England and HM Treasury) was that the FCA should use the SM&CR to give 'teeth' to industry codes and standards. FEMR also recommended the creation of a new industry code for the otherwise unregulated global foreign exchange (FX) market. This recommendation was fulfilled in May 2017 with the publication of the Global Foreign Exchange Committee's FX Global Code.²
- 1.8** In April 2017, we set out in our Mission³ that we would work with the financial services industry to create industry standards that cover activities in financial markets outside

1 <https://www.fca.org.uk/publication/consultation/cp17-37.pdf>

2 https://www.globalfxc.org/docs/fx_global.pdf

3 <https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf>



the Regulated Activities Order (RAO). We stated that these standards can be a useful way for the industry to police itself in support of our regulatory work, and can help firms to communicate expectations of individuals when linked to the SM&CR. We also made clear our interest in all financial activities, whether inside the regulatory 'perimeter' or not, and that we will act if we see serious harm or potential harm to financial services consumers occurring.

1.9 We see value in industry codes and standards where they help financial institutions and their staff to meet to proper standards of market conduct. FEMR found that previous industry codes and standards were ineffective because they provided little guidance to practitioners, were updated infrequently and lacked effective adherence mechanisms ('teeth').

1.10 It was in this context that we proposed our approach to recognising certain industry codes and standards covering unregulated markets and activities.

Reminder of our proposals

1.11 Banks, building societies, credit unions and dual-regulated investment firms are currently subject to the SM&CR. The vast majority of their staff are subject to the Individual Conduct Rules, including:

Rule 5: you must observe proper standards of market conduct.

1.12 All of the Individual Conduct Rules apply to both regulated **and** unregulated activities that individuals working for these authorised firms undertake in the course of their employment. For regulated activities, regulatory rules and requirements are the key determinant of proper standards of market conduct. For unregulated activities, firms and individuals must use their judgement to determine what 'proper standards of market conduct' are. FCA Guidance⁴ explains that market codes are one place (but not the only place) they may look to make such a determination. The FCA will consider whether a person's conduct complies with relevant market codes, exchange rules and other standards in the market.

1.13 We recently published near-final rules on the extension of the SM&CR to solo-regulated firms and insurers, including the application of the Individual Conduct Rules including Individual Conduct Rule 5.

1.14 To encourage individuals to observe certain market codes that in our view explain 'proper standards of market conduct', we proposed formally recognising these codes, publishing a list on our website. By conducting themselves in line with a recognised code's provisions, individuals would then be able to take comfort that this will tend to meet the obligation to observe 'proper standards of market conduct'. This would not, however, make it the only way to observe proper standards of market conduct.

1.15 We proposed criteria that codes would have to meet before being recognised. Recognition would apply for a period of 3 years (but could be renewed), to encourage regular review and updates to the standard, and to keep them front of mind for practitioners in the industry.

1.16 Our SM&CR rules do not change as a result of our proposals, nor would our powers or the circumstances in which we enforce our SM&CR rules. Firms and their Senior

4 COCON 4.1.5G

Managers, under the SM&CR, are expected to train, monitor and, where necessary, discipline their staff in relation to the Individual Conduct Rules.

- 1.17** We also asked a discussion question about whether firms should be subject to a requirement to observe proper standards of market conduct in relation to unregulated activities, in the same way as individuals are under the SM&CR.

Summary of feedback and our response

- 1.18** We received 39 responses to the consultation. Overall respondents were supportive of our aim to improve transparency about the status of market codes, and to be clear on our approach given the clear links included within the SM&CR. There was strong support for us encouraging the use of industry codes of conduct through a form of recognition, although we received a number of questions about how this would work, and suggestions for how it could be approached differently.
- 1.19** However, some respondents were concerned that recognising codes may imply a 'quasi-legal status' that undermines their voluntary nature, which may then affect the development and style of future codes. This was not our intention. Our policy aims to support and encourage the adoption of voluntary market codes, rather than to create enforceable obligations.
- 1.20** We will proceed with establishing a process through which we can recognise certain codes in priority areas, to encourage but not mandate their use. However, we are making some changes to the process and criteria for recognition, in light of responses received. We also provide in this statement further clarity in response to some of the questions posed to us in consultation feedback.
- 1.21** In our CP we proposed to consult the FCA's statutory panels and the Bank of England about codes proposed for recognition, and rely on code authors to consult with market participants on the content of their codes. We will now also publicly consult on each decision to recognise a code to provide transparency to market participants and let people share views if they disagree that a market code does represent proper standards within a particular unregulated market or activity.
- 1.22** In relation to the discussion element of CP17/37, respondents generally understood the case we had made as to why a change to Principle 5 of the FCA Principles for Businesses might be desirable. However, there were significant concerns that this would bring in regulation 'by the backdoor', without the appropriate parliamentary scrutiny of legislative changes to the RAO. Some felt this sort of change was unnecessary given the SM&CR, and that we had already demonstrated our ability and willingness to take action in the case of the FX enforcement action using existing powers. Taking this feedback into account, we will not consult on extending principle for businesses 5 to wholly unregulated activities⁵ at this time but will continue to consider the case for this in light of the effectiveness of the code recognition process and other FCA priorities.
- Equality and diversity considerations**
- 1.23** We have considered the equality and diversity issues that may arise from the proposals in this PS, although we did not receive any feedback on these considerations during the consultation process.

⁵ Principle 5 already applies to some unregulated activities e.g. where the unregulated activity is carried on in connection with certain regulated business (see PRIN 3.2.1AR(3))



1.24 Overall, we do not consider that this policy adversely impacts any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

Next steps

1.25 We do not expect firms to make significant changes to their systems and controls in light of our final handbook changes and approach. Authorised firms and the individuals subject to SM&CR obligations already need to consider 'proper standards of market conduct' and many already follow specific industry market codes. As a result of the policy within this PS, firms and individuals do not need to follow any particular codes but they may find it helpful to look at FCA-recognised codes in considering the proper standards of market conduct for their activities.

1.26 Authors of market codes are welcome to contact us to discuss potential recognition of their market codes upon publication of this policy statement. Further information can be found at www.fca.org.uk/about/recognised-industry-codes or by emailing recognisedindustrycodes@fca.org.uk.

What we will do next

1.27 The FCA's supervisory and enforcement approach will not change as a result of this policy; our general approach to unregulated market activities and codes is detailed in the CP and Chapter 2 below.

2 Our general approach to Industry Codes and unregulated markets

- 2.1** This chapter summarises the responses received on each of the questions we asked in CP17/37, together with our feedback and a description of the changes we have made to the final rules.

Senior Managers and Certification Regime

- 2.2** In consultation CP17/37 we outlined how industry codes are relevant for elements of the SM&CR (e.g. certification and the Individual Conduct Rules). At the time of publication, only banks, building societies, credit unions and dual-regulated investment firms were subject to this regime (the 'banking regime'), and insurers were subject to a similar Senior Insurance Managers Regime (SIMR). On 4 July 2018 we published our final policy extending the SM&CR to Insurers and FCA-solo regulated firms⁶ which comes into effect on 10 December 2018 for insurers and 9 December 2019 for solo-regulated firms. These new regimes have a different application of the individual conduct rules to unregulated markets, which is set out in PS18/14 and PS18/15.

The general approach

- 2.3** In Chapter 3 of CP17/37 we described our general approach to overseeing unregulated financial markets and the current relationship between 'market codes' (without any FCA recognition status) and FCA rules.

- 2.4** We asked:

Q1: *Do you think we have been sufficiently clear about how we will view industry codes of conduct in our regulatory activities, including supervision and enforcement? If not, what further questions do you have about our general approach?*

- 2.5** Respondents were supportive, and thought the approach was a clear and proportionate way for the FCA to improve conduct and reduce risk of harm in unregulated markets given the link with the SM&CR. They agreed that market codes can articulate clear conduct expectations in unregulated markets and activities, and welcomed our support for market participants setting such standards of conduct.

⁶ PS18/14: Extending the Senior Managers and Certification Regime to FCA firms – Feedback to CP17/25 and CP17/40, and near-final rules - www.fca.org.uk/publications/policy-statements/ps18-14-extending-senior-managers-certification-regime-to-fca-firms and PS18/15: Extending the Senior Managers & Certification Regime to insurers – Feedback to CP17/26 and CP17/41 and near-final rules - www.fca.org.uk/publications/policy-statements/ps18-15-extending-senior-managers-certification-regime-to-insurers



2.6 Some respondents were concerned that the current rules, including Individual Conduct Rule 5⁷, mean that compliance with market codes is seen as compulsory rather than voluntary. Some of these respondents argued that mandating codes would competitively disadvantage authorised firms and could create an un-level playing field compared with non-authorised firms operating in the same markets. These respondents felt we should only enforce against rule breaches, rather than market code breaches.

2.7 Others wanted clarity on the status of market codes generally under the SM&CR, and asked:

- whether an individual would be held accountable for complying with codes they had not signed up to
- how these rules would apply to people working for UK authorised firms serving non-UK clients on a cross-border basis, or serving UK clients from overseas branches
- whether the general approach applies to codes in regulated markets.

Our response

We described the general approach to market codes in the consultation paper and outlined how market codes fit with the SM&CR, and conversely how the SM&CR helps give 'teeth' to codes. We did not propose any changes to our existing and draft SM&CR rules but we asked for views on whether our outlined approach to unregulated activities and market codes was clear.

We clarify issues raised through the consultation feedback below.

We understand the points made about un-level playing fields and accept that there may be additional cost in meeting proper standards for unregulated financial activities. The costs and benefits of these requirements were previously consulted on during the implementation of the SM&CR and the extension of that regime. While our policy encourages FSMA authorised firms to follow market codes through the obligation to observe proper standards in the SM&CR, in practice many of these codes will also be followed by non-authorised firms, including non-financial corporates.

Complying with high standards can be a competitive advantage, particularly where customers seek out firms that provide quality services on fair terms. We expect certain standards from authorised firms, and want to avoid lower standards in unregulated activities impacting confidence in financial markets.

As noted in the consultation, we do not intend to directly supervise compliance with market codes. Market codes may, however, be relevant for firms when meeting their SM&CR obligations. The obligations of the SM&CR will form part of our future supervisory focus. We discuss the

⁷ COCON 2.1.5R: "Rule 5: You must observe proper standards of market conduct."

territorial application of the Individual Conduct Rules and market codes in paragraph 3.14 below.

Our Mission document,⁸ together with our Approach to Supervision⁹ and Enforcement¹⁰ documents set out our approach to our regulatory functions.

Regulated markets

The SM&CR requirements, including the Individual Conduct Rules, where they apply for banks, building societies, credit unions and dual-regulated investment firms, are relevant for both their regulated and unregulated activities. Whether a person's conduct complies with Individual Conduct Rule 5 may be evidenced by whether they, or their firm, comply with relevant market codes when these set out the relevant requirements and standards of the market. In regulated markets, this is in addition to rules and principles of the FCA Handbook. Industry guidance under our confirmed industry guidance approach¹¹ may also help with understanding expectations under FCA Handbook rules. We are not changing our approach to confirmed guidance because of this new policy.

Supervision

We stated in CP17/37 that we do not intend to supervise firms or individuals directly against any market codes in unregulated markets. Instead, we expect firms currently subject to the SM&CR to train and monitor their staff.¹² Our role would be to make sure that firms meet their governance and systems and control obligations, including under the SM&CR. Named Senior Managers will have responsibility for taking reasonable steps to ensure their firm is compliant with regulatory requirements placed on the firm and their staff. Compliance with codes may be one way to evidence they are compliant with our overall governance requirements.

Enforcement

In CP17/37, we noted that the Individual Conduct Rules were binding and would allow us to take enforcement action against individuals. Enforcement action can only be taken in respect of the individual conduct where the individual is personally culpable.¹³ We also restate our comments made in the FCA Mission about the limited circumstances when we might take enforcement action in relation to unregulated activities, with a focus on where there is serious harm caused to consumers or financial markets. Codes may be evidential and relied upon in determining what proper standards are, or were believed to be, at the relevant time. We will not take action based solely on a breach of provisions in market codes (recognised or not).

8 www.fca.org.uk/publication/corporate/our-mission-2017.pdf

9 www.fca.org.uk/publications/corporate-documents/our-approach-supervision

10 www.fca.org.uk/publications/corporate-documents/our-approach-enforcement

11 www.fca.org.uk/about/rules-and-guidance/confirmed-industry-guidance

12 COCON 2.3

13 COCON 3.1.3G



Recognition of a market code does not change our enforcement approach. By conducting themselves in line with a recognised code's provisions individuals and firms may take comfort that this will tend to indicate compliance with their obligation to observe proper standards of market conduct. It is not a new basis for enforcement, and does not enhance our ability to take enforcement action.

Being a signatory to a code does not mean parties are more likely to be held accountable if they do not follow the code. Recognised codes will be relevant for all parties who undertake relevant unregulated activities. COCON 3.1.2 states that we will have regard to the precise circumstances when deciding whether the Individual Conduct Rules have been complied with. Under section 64B of FSMA, firms are expected to take all reasonable steps – such as providing the necessary training – to ensure staff subject to the Individual Conduct Rules understand how the rules apply to them. In deciding whether to take action we would consider if the misconduct was deliberate or the standard of conduct was below that which would be reasonably expected given the circumstances, and it resulted in consumer harm or distorted market integrity.

3 Recognising codes

- 3.1** This chapter sets out the feedback we received, our responses and the final policy position on a proposal to recognise particular industry-written codes. We detail the status of recognition, the process for gaining this status and the criteria we will use to assess codes.

Recognition proposal

- 3.2** We proposed a process to recognise certain industry codes for the purposes of the SM&CR. Thereafter, staff in regulated firms follow a FCA-recognised industry code they could rely on its recognition status and take comfort that their conduct would tend to comply with 'proper standards of market conduct' for their unregulated activities. This gives an incentive to follow recognised codes and to improve their standards of conduct in relevant unregulated markets.
- 3.3** We asked the following two questions:
- Q2:** *Do you agree with our proposal to recognise certain industry codes of conduct in unregulated markets? If not, please provide your reasons.*
- Q3:** *What challenges do you foresee for us or industry with recognising certain industry codes?*
- 3.4** Respondents were broadly in favour of the proposal, considering it a proportionate way for the FCA to support and raise awareness of market codes in unregulated markets. Having a list of recognised codes would clarify expectations in these markets.
- 3.5** Some respondents were concerned that by listing particular codes on the FCA website and providing 'quasi-regulatory status', codes would move from being voluntary, to expected, or even compulsory.
- 3.6** Respondents noted that some codes are aspirational in nature, high-level and not drafted with the same clarity as rules. They felt some codes would therefore be unsuitable for recognition or would require redrafting. Representatives of authorised firms stated that they would always aim to comply with FCA recognised codes, but were concerned about the complexity and cost of complying and monitoring compliance with codes, particularly if a large number were recognised. If recognition implies that firms would be held to higher standards than before, this may discourage firms from following, or authors from proposing codes for recognition.
- 3.7** Respondents also commented on other issues including: the types of codes we may recognise; what 'unregulated' activities are, whether our proposals were relevant for retail as well as wholesale market activities, and the territorial scope of our proposal.
- 3.8** We also received requests to publish a list of any codes that had been rejected for recognition.



Our response

We will proceed with our proposals to create a framework to recognise certain industry codes covering unregulated markets, when code authors request this status. We still think that this is a simple and proportionate way to encourage, but not mandate, the development of, and adherence to, market codes that define proper standards of conduct, linked to the SM&CR.

Recognition does not imply that an individual must follow a particular market code. It is not comparable with an FCA rule. However, if their firm is subject to the SM&CR, Senior Managers and other individuals will be subject to Individual Conduct Rule 5 and will be obliged to meet proper standards of market conduct. Following a recognised code will be one way, but not the only way, to discharge that obligation, and may be applied proportionately to the activities undertaken. We do not intend to directly supervise compliance with particular codes, even if recognised, in unregulated markets. Some parties asked if we would operate a comply-or-explain model for recognised codes. This is not our intention.

Failure to follow a recognised code will not in itself be considered a breach of Individual Conduct Rule 5. However, action may be taken if an individual deliberately chooses not to observe proper standards, or conduct falls below that which would be considered reasonable, and results in harm to consumers or markets. If people choose to follow a recognised code, however, they can rely on this status and gain some certainty and comfort that they are meeting their SM&CR obligations. This should incentivise individuals and firms to follow recognised codes.

The written form and style of industry codes does not need to be the same as regulatory rules, and we expect that most industry codes will not be. They should be clear on what individuals need to do, or not do, when they perform unregulated activities. We do not expect codes will need to be substantially revised to accommodate the recognition approach. Recognised codes may define aspirations or a description of current good practice. However, we would welcome applications to recognise aspirational codes that aim to improve existing standards of conduct, where appropriate.

We accept that if we were to recognise lots of codes in a short period, this could be onerous for firms, if they needed to update their policies, systems and procedures or retrain staff. It would also be challenging for us to give due consideration to a large number of codes. We expect to recognise only a small number of codes, in priority areas – e.g., where codes could helpfully fill a regulatory gap, taking into account the potential harm, size of the market sector and the ability for a code to mitigate the associated harm.

Some respondents suggested listing rejected codes. We think, however, that listing rejected codes would not necessarily help individuals and authorised firms understand what 'proper standards' are for the unregulated activities they undertake, and would not achieve our objective of supporting and encouraging industry efforts to enhance

standards of conduct. There are numerous reasons why we might not recognise a code (e.g., if it is not a current priority), and they may not relate to whether the code does, or does not, describe proper standards.

If codes are rejected because they do not describe proper standards of market conduct, we will work with the code authors to make sure they understand why we think that the codes fall short. We may also consider publishing a statement to highlight the industry practice about which we are concerned.

Types of code

- 3.9** In CP17/37 we provided our definition of a 'market code' but respondents asked for more information. Many asked what codes or types of code we were considering for recognition, and asked us to publish this in our policy statement.

Our response

Market codes go by many names and take many forms – e.g., code of conduct/practice/ethics, standards, guidance, guidelines, best practice. We do not think it is appropriate for us to restrict the form of codes which would be suitable for recognition. We view the content of the code to be more important than the form.

The International Federation of Accountants' definition is, however, similar to our own view of a code:

'Principles, values, standards, or rules of behaviour that guide the decisions, procedures and systems of an organisation in a way that (a) contributes to the welfare of its key stakeholders, and (b) respects the rights of all constituents affected by its operations'.¹⁴

We will consider the term 'market codes' in line with this definition. This does not define how the term is used elsewhere in the FCA Handbook.

Code authors should consider their codes against our recognition criteria. If the code meets the criteria, they can contact us to seek recognition or discuss the matter further.

We are not mandating any specific codes, nor will we pressure code authors to submit their codes for recognition. We have no target list of codes. It is a matter for code authors and signatories if they wish to submit their codes to us for recognition.

Codes submitted for recognition should be focused on standards of market conduct, given the link with Individual Conduct Rule 5, and

¹⁴ International Federation of Accountants Good Practice Guidance, "Defining and Developing an Effective Code of Conduct for Organizations", 2007



firms may only rely upon recognised codes in that respect. Where appropriate, we may choose to just recognise specific parts of codes that deal with standards of conduct.

Definition of 'unregulated'

3.10 In our view, 'unregulated activities' are activities that do not fall within the definition of 'regulated activities' in the RAO. Respondents noted that some unregulated activities in this description are caught by other regulation or legislation – for example, trading in energy contracts is subject to the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT), overseen by the Gas and Electricity Markets Authority (OFGEM).¹⁵ Some activities are unregulated in the sense they do not require authorisation, however they are subject to other FCA rules – for example, market abuse rules, or commodity position limits. These include spot FX trading, trading in physical commodity assets like oil, and lending activities involving small and medium-sized enterprises.

3.11 Respondents noted that some elements of regulated activities are not covered by regulatory rules, and asked whether they would be considered 'unregulated'. They asked us to clarify whether we would focus on recognising codes covering unregulated financial activities.

Our response

Although 'regulated' and 'unregulated' activities are clearly defined for authorisation purposes, we accept that some activities may not be FSMA activities but may be regulated activities in other government or regulatory regimes. It is unlikely that we would recognise a code if the content related to, or was covered by other forms of legislation or regulation.

Market codes covering FSMA regulated activities or markets can be helpful and we will continue to consider these under our framework for confirmed industry guidance as opposed to the recognition route described in this statement.

We will focus on recognising codes relating to unregulated activities in financial markets, however we may consider recognising codes on non-financial activities where they are closely connected to regulated activities – e.g., trading of physical assets or commodities, for which trading in the derivative thereof would be a regulated activity.

An activity which is not a regulated activity, but is conducted in connection with, or is held out as being for the purposes of certain regulated activities, is defined as an 'ancillary activity' in the FCA Handbook and will often be directly subject to our rules.

¹⁵ www.ofgem.gov.uk/electricity/wholesale-market/european-market/remit

Retail markets

- 3.12** We received a number of responses from representatives of firms operating in retail, as well as wholesale sectors. As this policy proposal originated, in part, from the FEMR review of wholesale FICC markets, some respondents felt the proposal would be more applicable to wholesale markets.

Our response

Due to greater incidence of consumer vulnerability, most retail financial market activities are regulated. We still think that there is benefit to recognising retail codes where they are not and where codes could help determine proper standards of conduct in dealing with their customers. It is difficult to draw a line between 'retail activities' and 'wholesale activities' and some involve both professional and retail clients. We therefore remain open to the possibility of recognising retail market codes, providing that the interests of retail clients have been appropriately considered. This is the existing approach for FCA confirmed industry guidance for regulated activities. We have previously confirmed guidance covering retail investment, insurance and banking activities.

Un-recognised codes

- 3.13** Several respondents asked us to clarify our view on codes that are not submitted for recognition, as well as unsuitable codes that were rejected.

Our response

We will be proportionate in terms of the number of codes that we will recognise, and will focus recognition efforts on codes that help fill a regulatory gap. We will only consider recognising a small number of codes.

Industry codes that are not recognised may still be helpful for individuals subject to the SM&CR in determining the proper standard of market conduct. Individuals will need, as now, to apply their judgement to determine which unrecognised codes they want to adhere to.

There will be codes that we decide not to recognise (before or after public consultation). Granting recognition status to codes will be aligned with our regulatory priorities at that time. Our decision not to recognise a code should not necessarily be seen as an indication that the code does not provide guidance on appropriate standards.

We will retain discretion on whether to accept a code for recognition. The prioritisation of which codes to recognise will be determined in line with



our existing prioritisation process, including sector views. Prioritisation criteria may include:

- the size and impact of the unregulated sector, activity or market
 - the potential for consumer harm and whether the code could mitigate this harm
 - the prospect of future regulation of the market sector or activity
 - how the activities interact with activities within the FCA's regulatory perimeter
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Territorial application

3.14 Many respondents noted that some codes are global in nature, and asked for clarity on how FCA recognised codes would impact:

- Staff of UK authorised firms, working in overseas entities
- Individuals working at UK established firms dealing with overseas clients

3.15 They were concerned that where the SM&CR applies to overseas offices or for businesses with overseas clients, FCA recognised codes may conflict with overseas local law or market practice.

Our response

Code recognition is tied to the SM&CR requirements and the Individual Conduct Rules, which have defined territorial application.¹⁶ Individual conduct rules for senior managers and material risk takers apply in any locations their activities take place. For all other individuals caught by the SM&CR, the Individual Conduct Rules apply in relation to their activities performed from an establishment maintained in the UK by their employer, or when dealing with clients in the UK from an overseas establishment of a UK authorised firm.¹⁷

We will consider recognising codes that impact unregulated activities that take place in UK markets or with UK consumers, including global codes relevant for UK markets.

Where individuals working for authorised firms deal with clients or undertake activities in non-UK markets, they should consider what proper standards are for those markets (e.g., defined by local laws, codes or practice).

¹⁶ COCON 1.1.9 and 1.1.10

¹⁷ For a Solvency II firm or a small non-Directive insurer COCON applies to the conduct of persons if the conduct is performed from an establishment maintained in the United Kingdom by the firm in relation to whom that person carries out controlled functions (see COCON 1.1.10R(2)(a)(ii)).

Handbook changes

3.16 Proposed Handbook changes for the recognition proposal were set out in Appendix 1 of the consultation. We asked:

Q4: *Do you agree with the proposed changes to the FCA Handbook designed to give effect to our proposals? If not, please provide your reasons.*

3.17 Respondents generally agreed that our proposed Handbook changes were appropriate. Some said that it would be helpful to have more detail regarding the status and process for recognition contained within the Handbook. Others asked for an explicit Handbook reference that not complying with a recognised code would not mean that an individual had breached the relevant rule. We were also asked to strengthen the text to provide stronger protection to individuals following recognised codes, for example, by 'confirming' that by doing so individuals would be meeting their SM&CR obligations, instead of it would 'tend to indicate'. We were asked to clarify that we will only recognise codes in financial markets, and to define 'financial markets'. Finally, we were requested to include a reference in SYSC 4.7 covering which senior manager is responsible for individuals' adherence to codes under the SM&CR.

Our response

We have considered the feedback and amended the Handbook text to reflect our final policy position (set out in Appendix 1). This includes making clear that recognised codes may be relevant for an individual's obligation to conform to proper standards of market conduct, as well as firms related obligations under the SM&CR.

We have kept the language that a code tends to indicate compliance with proper standards of market conduct. This is because Industry codes are not usually written in legal language, and are sometimes high level. We expect individuals to consider both the spirit and letter of code provisions, to make sure they fully meet proper standards of market conduct.

We comment above on the types of codes we will consider recognising and some of the factors we will consider in our assessment. We do not believe it is necessary to formalise this within the Handbook, including defining the term 'financial markets' which is also defined in FSMA. SYSC 24 sets out which Senior Manager Functions are required, several of which may be impacted by codes we recognise. We do not think it is appropriate to create new SM&CR responsibilities specifically for compliance with market codes.

Process for recognition

3.18 CP17/37 proposed a process that relies on code authors approaching us for recognition. This included an interim review and discussion with the code author,



consultation with the FCA statutory panels and Bank of England, before being recognised by us and published on our website. Recognition was proposed to last for 3 years, which could be extended if appropriate. We noted that we would recognise codes in priority areas.

3.19 We asked:

Q5: *Do you agree with our proposed process for recognising certain industry codes? If not, how should we amend it?*

3.20 Respondents felt that a clear process was important for recognising codes. A number of trade bodies and representatives of the legal community felt that we should publicly consult on each code recognition decision. A public consultation would in their view enhance transparency and accountability, and meet our obligations under the Financial Services and Markets Act to exercise regulatory functions transparently and to consult with affected stakeholders.

3.21 We received feedback that our process was too focused on new codes and that we should consider applying our policy to the existing codes that may be suitable for recognition. Respondents asked which codes we would prioritise, and asked that we only recognise codes following the author's consent.

3.22 CP17/37 stated that we would not participate in the drafting of new codes. Some respondents felt we could act as a neutral arbitrator in the development of codes.

3.23 One respondent suggested that discussions between code authors and the FCA should be time limited, e.g., for a 3-month period, to prevent the process being drawn out. Some respondents also thought it inappropriate for code authors to provide ongoing guidance on codes.

3.24 We received several supportive comments on the 3-year recognition limit. Others suggested longer or even an indefinite recognition period due to the challenges and length of time it takes to develop codes. Some respondents also requested transitional or implementation periods ahead of recognition and de-recognition to avoid 'cliff-edge effects'.

Our response

We agree that public consultation enhances transparency and would give all stakeholders an opportunity to state their opinion on whether a code should be recognised or not. We will therefore publicly consult on the proposed recognition decision, most likely through the FCA's quarterly consultation papers (QCP). QCP chapters would list the names of market codes that are being considered for recognition, including descriptions of the content of the codes and details of how the codes meet the recognition criteria. We will only consult on whether or not to recognise a code, and not on the code's content, which will be the responsibility of the code author. We will consider consultation feedback in determining whether to provide recognition status. In line with the proposal in CP17/37, we will also consult our statutory panels and the Bank of England on the code recognition.

We will only consider recognising codes that are put forward by the code authors. This reflects that the codes are voluntary and are not FCA requirements. This may be new codes or codes which are already in existence. Codes must meet the recognition criteria, but must also help us pursue our statutory objectives and relevant priorities.

We do not think it is appropriate for us to have a formal role in drafting or adjudicating on industry codes in unregulated markets. We may, however, offer our views to code authors where we deem this appropriate.

We understand the benefits of time limiting the engagement between code authors and the FCA during the recognition process. This would, however, be inflexible. The period of time necessary to review and discuss codes with their authors will depend on the nature, length and complexity of the code. Code authors will be responsible for promptly providing sufficient information so that we can consult on whether or not to recognise their code.

We will not provide interpretive guidance on code provisions. Code authors may answer questions on their codes. Providing this is not mandatory for recognition status and we will not necessarily extend recognition to any interpretative guidance or Q&A material. There will be no obligation for code authors to maintain registers of individuals signed-up to or following their codes.

In deciding the length of time to recognise a code, there is a balance between stability for market users and ensuring codes keep up-to-date with market developments. A time-limited period of recognition was suggested to encourage regular review and updates to codes, incorporating FEMR's findings that one reason codes have been ineffective is because they have not been revised and became out of date. We believe 3 years of recognition is appropriate, with the ability for code recognitions to be updated earlier if necessary and for 3-year periods to be renewed if recognised codes remain relevant. When we recognise a code we will do so in respect of the code as it stands at a particular date. Where codes no longer represent proper standards of market conduct, we will withdraw recognition before the end of the 3-year period.

We understand the operational challenges for firms to respond quickly to FCA recognition. In practice, we expect recognised codes will already have market wide support and are likely already being followed. Compliance with codes remain voluntary and only one way to demonstrate proper standards of market conduct. Individuals are welcome to follow appropriate alternative approaches to meet their obligation to observe proper standards of market conduct. Firms and individuals will be notified of the potential for recognition of a code through the FCA QCPs and potentially also code authors. Therefore, we do not think an implementation or transitional period will be needed. The period of recognition will be listed on the FCA website, and notice of the expiry of recognition will also be publicised. Authors of recognised codes will be responsible for telling us about any proposed changes to their codes.



Recognised codes will be published on the FCA website, with the recognition period and a link to the code. Following feedback, we will now also maintain lists of codes that have been derecognised so that parties can review any codes that were recognised in the past.

Recognition criteria

3.25 We proposed a set of criteria to help us determine whether or not to recognise particular industry codes or standards. This was to make sure that only appropriate codes would be recognised, and to increase transparency.

3.26 We asked:

Q6: *Do you agree with the criteria proposed for deciding which codes to recognise? If not, what additional or alternative criteria should we consider?*

3.27 Overall, respondents considered that the proposed criteria were appropriate. Respondents agreed that codes should be consulted upon by their authors, and should be available free of charge. Additional criteria were also suggested, including that codes should be comprehensive, value-based, and have some independent method for being monitored and enforced. The Transparency Task Force¹⁸ also informed us of their ongoing work to create a Publicly Accessible Specification for defining and judging effective conduct codes. This might be another way that code authors could demonstrate that their code is a clear and practical articulation of the proper standard.

3.28 We also received feedback that participation in code development should be free. Some asked what evidence a code author would need to provide that the recognition criteria had been met.

3.29 We received a lot of feedback on the following two criteria:

- 'The code represents an effort to raise standards taking into account the views of all relevant stakeholders during its development'
- 'The code has been subject to public scrutiny that has allowed alternative views to be expressed and taken into consideration, including from firms, public authorities, consumer groups and academics'

3.30 Some felt these criteria were too restrictive, and that consultation would slow down code development. Respondents wanted to know who the 'relevant stakeholders' were and what would happen if they did not engage with the process. Some respondents also asked for clarification on whether 'taking into account' meant all views submitted had to be answered or acted upon. They asked for clarification on the FCA's expectation on the type and length of public consultation. We were asked whether a consensus was needed before a code could be submitted for recognition.

¹⁸ The Transparency Task Force is a collaborative, campaigning community, dedicated to driving up the levels of transparency in financial services, right around the world – www.transparencytaskforce.org/

Our response

As the proposed criteria were generally supported, we will go ahead with the criteria for determining recognition, with only a few minor amendments. The full set of criteria is outlined below and will be published on the FCA website at www.fca.org.uk/about/recognised-industry-codes.

We believe it is important that industry codes have the broad support of the relevant industry and that the interests of relevant parties impacted by the code are appropriately considered. This can be achieved through consulting with a reasonable number of parties who may be impacted or have a view on codes, or by publishing a draft code for comment. This should include parties beyond those who have been involved in drafting the code. We will not prescribe the form of the consultation, or who the relevant stakeholders are, but would look for evidence that efforts have been taken to test the code with interested independent parties. We accept that not all impacted stakeholders will engage with the consultation. Interested groups should have the opportunity to raise concerns.

Where particular codes do not have broad industry support, or where there are competing and conflicting codes in the market, this may lead to us not recognising them.



Final recognition criteria

The code must advance the FCA strategic objective of ensuring that the relevant markets function well and one or more of our three operational objectives of:

- i.** securing an appropriate degree of protection for consumers
- ii.** protecting and enhancing the integrity of the UK financial system
- iii.** promoting effective competition in the interests of consumers.

The code must also:

- i.** focus on market activities and issues which are not already covered by binding regulatory rules;
- ii.** represent an effort to define, set or raise standards taking into account the views of relevant stakeholders during its development;
- iii.** have been subject to scrutiny that has allowed alternative views to those of the authors to be expressed and taken into consideration, including (as appropriate) from firms, public authorities, consumer groups and academics;
- iv.** be publicly available and free for all parties who wish to use it;
- v.** not condone any practices the FCA has previously objected to, or which the FCA would expect not to condone.

Codes should aim to:

- i.** be a widely supported, clear, practical and unambiguous articulation of the proper standard of market conduct, covering significant conduct issues that a reader would reasonably expect to be covered.
- ii.** set standards broadly comparable in substance or intended outcomes with those that exist in other analogous financial markets.
- iii.** encapsulate what would otherwise be considered proper standards of market conduct among knowledgeable, experienced and reasonable market participants representing their industry and profession.

4 Principle for Businesses 5

- 4.1** This chapter sets out the feedback we received on the two discussion questions regarding the merits of extending the application of Principle 5 of the FCA Principles for Businesses (***a firm must observe proper standards of market conduct***) to unregulated activities of authorised firms.

Extending the application of Principle 5

- 4.2** In the discussion chapter of CP17/37 we noted the possible anomaly of requiring all of the staff within an authorised firm to comply with proper standards of market conduct in unregulated financial activities, but not requiring the firm itself to do so because principle 5¹⁹ only applies to regulated activities.²⁰ This may be an important distinction where, for example, a firm's business model or approach (rather than the actions of a few individuals) conflict with the agreed proper market standards and causes either market or consumer harm. We therefore set out for discussion whether we should have a greater ability than now to take action against authorised firms causing market or consumer harm through unregulated market activity, via the extension of Principle 5 of the FCA Principles for Businesses. We noted that if we received positive feedback on this, we would undertake a public consultation and, cost and benefit analysis.

- 4.3** We asked:

Q7: *Do you believe the FCA should consider extending the application of Principle for Businesses 5 (A firm must observe proper standards of market conduct) to unregulated as well as regulated activities? If not please state why.*

Q8: *What benefits and challenges do you believe this would pose to FCA authorised firms, the FCA or financial markets more generally?*

- 4.4** These questions elicited a range of responses. Some people felt we already had enough powers to tackle misconduct in unregulated markets, or that we should formally request more powers from the Government rather than seek to rely on codes. Others thought the proposals would allow us the ability to tackle consumer harm related to unregulated activities of authorised firms. Most respondents felt a full consultation would be important for properly considering the details, benefits and costs of this policy proposal.

- 4.5** Respondents noted that the extension of Business Principle 5 would be a significant change to the FCA's powers, and questioned whether FSMA should be amended. Other respondents suggested that some unregulated activities should be brought within the regulatory perimeter through a change in primary legislation. Respondents

19 PRIN 2.1.1R – 5: Market conduct – A firm must observe proper standards of market conduct.

20 Principle 5 can also apply to unregulated activities where they are 'ancillary' to certain regulated activities (see PRIN 3.2.1AR(3)).



referenced our previous action in unregulated markets, including the FX and LIBOR enforcement cases. We also received feedback that it is more appropriate for us to focus on the role and responsibilities of individuals, as opposed to the authorised firm.

- 4.6** The feedback suggested that the extension of Principle for Businesses 5 would increase costs for firms, in terms of compliance gap analysis, documentation and monitoring capabilities, at a time when firms are already facing significant regulatory change costs. Respondents questioned whether this power would divert our attention from regulated activities, and whether we had the resources, knowledge and skills to monitor and take action in unregulated markets. One person noted that this power could confuse consumers about our role in unregulated markets.
- 4.7** Other respondents favoured the proposal, with some firms saying that they already make sure all of their business activities (whether regulated or not) conform to proper standards of market conduct, with appropriate monitoring. Consumer groups and charities also noted that this proposal would allow us to tackle identified areas of misconduct causing consumer harm in relation to the enforcement and collection of unregulated debt. There were also comments that more oversight of unregulated financial activities could prevent firm failure and a reduction of FSCS funding required to compensate consumers.

Our response

At this time we have decided not to proceed with taking this proposal forward to consultation. Instead, we will monitor and assess the effectiveness of the recognition of codes policy, alongside the further SM&CR extension, and may revisit this proposal in the future.

Annex 1

List of non-confidential respondents

Association for Financial Markets in Europe

Aon Hewitt Limited

Association of British Insurers

Association of Foreign Banks

Association of Investment Companies

Association of Mortgage Intermediaries

Bank of New York Mellon

Chartered Banker Institute

City of London Law Society Regulatory Law Committee

European Venues and Intermediaries Association

FICC Markets Standards Board Limited

Finance & Leasing Association

Financial Services Consumer Panel

International Capital Market Association

International Swaps and Derivatives Association

Investment & Life Assurance Group

Investment Association and the Alternative Investment Management Association
(joint-response)

Lending Standards Board

Loan Market Association

London Bullion Market Association

London Metal Exchange

Market Integrity Team of the Transparency Task force

Money Advice Trust



National Pawnbrokers Association

NatWest Markets

Personal Investment Management and Financial Advice Association

Professional Standards Council for Invoice Finance and Asset Based Lending (UK Finance)

Rosediem Consulting Limited

SACM Ltd

Simmons & Simmons LLP

Standard Chartered Bank

Tax Incentivised Savings Association

Tenet Group Ltd

Annex 2

Abbreviations used in this paper

CBA	Cost-benefit analysis
COCON	Code of Conduct sourcebook
CP	Consultation Paper
DEPP	Decisions Procedure and Penalties manual
EG	Enforcement Guide
EU	European Union
FCA	Financial Conduct Authority
FICC	Fixed Income, Currency and Commodity
FSMA	Financial Services and Markets Act 2000
FX	Foreign Exchange
Individual Conduct Rules	The FCA Handbook rules at COCON 2.1
LIBOR	London Inter-Bank Offered Rate
PRIN	Principles for Businesses Sourcebook
PS	Policy Statement
QCP	Quarterly Consultation Paper
RAO	The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended)
SIMR	Senior Insurance Managers Regime
SM&CR	Senior Managers and Certification Regime



We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Appendix 1

Made rules (legal instrument)

FCA RECOGNISED INDUSTRY CODES (DEPP AND EG) INSTRUMENT 2018

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of:
- (1) the following powers and related provisions of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 69 (Statement of policy);
 - (b) section 139A (Power of the FCA to give guidance); and
 - (c) section 210 (Statement of Policy).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 18 July 2018.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Decision Procedure and Penalties manual (DEPP) is amended in accordance with Annex B to this instrument.

Material outside the Handbook

- F. The Enforcement Guide (EG) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the FCA Recognised Industry Codes (DEPP and EG) Instrument 2018.

By order of the Board
28 June 2018

Annex A**Amendments to the Glossary of definitions**

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

FCA-recognised industry code A market code prepared by a *private person* that prescribes or prohibits forms of conduct or behaviour in relation to activities in financial markets, recognised by the FCA under its industry code recognition process and procedures and listed on the FCA website.

Annex B

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text.

6 Penalties

...

6.2 Deciding whether to take action

...

- 6.2.1 G The *FCA* will consider the full circumstances of each case when determining whether or not to take action for a financial penalty or *public censure*. Set out below is a list of factors that may be relevant for this purpose. The list is not exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

...

(4A) *FCA-recognised industry codes:*

Behaviour that is in line with a *FCA-recognised industry code* will tend to indicate compliance, in carrying out *unregulated activities*, with applicable *FCA rules* that reference ‘proper standards of market conduct’. In such cases, the *FCA* will usually not take action against a person for behaviour, in relation to *unregulated activities*, that it considers to be in line with the relevant *FCA-recognised industry code*.

...

Annex C

Amendments to the Enforcement Guide (EG)

In this Annex, underlining indicates new text.

2 The FCA's Approach to Enforcement

...

2.10A FCA-recognised industry codes

2.10A.1 The FCA believes that industry codes of conduct have an important part to play in a principles-based regulatory environment. Individuals may choose to follow, and firms have regard to, such codes as a means of seeking to meet the FCA's requirements to conform to proper standards of market conduct. This will be true especially where industry codes of conduct have been 'recognised' by the FCA. DEPP 6.2.1G(4A) confirms that behaviour that is in line with an FCA-recognised industry code will tend to indicate compliance, in carrying out unregulated activities, with applicable FCA rules that reference 'proper standards of market conduct'.

2.10A.2 Equally, however, FCA-recognised industry codes, and codes that have not been recognised, are not mandatory. The FCA does not regard adherence to industry or market codes as the only means of complying with applicable FCA rules. Rather, they may provide an articulation of proper standards of market conduct which meets the FCA's requirements.

