

WHISTLEBLOWING

Regulatory health check for financial institutions' whistleblower frameworks

By Polly James, May 2020

www.bcplaw.com

BRYAN
CAVE
LEIGHTON
PAISNER 

This practice note acts as a checklist for use by financial institutions to give their existing whistleblower framework a regulatory health check.

SCOPE OF THIS NOTE

This practice note provides a checklist for financial institutions to use to perform a health check of their existing whistleblower protection framework, to:

- Ensure the framework reflects the most recent regulatory expectations in this area.
- So far as possible, protect both firms, and those individuals with specific responsibility for managing the framework, from regulatory exposure.

Why does my firm's whistleblower framework need a regulatory health check?

There are two key reasons why now is a good time for a firm to carry out a regulatory health check of its whistleblower framework.

Reason 1: SM&CR

One consequence of the focus on personal accountability brought about by the introduction of the senior managers and certification regime (SM&CR) in financial services has been an increase in the volume of whistleblower reports made by financial services workers. With many thousands of financial services workers faced with personal regulatory responsibility for the first time under the Individual Conduct Rules, it is understandable that some should feel moved to raise concerns that they might, under the previous regime, have kept quiet about for the sake of an easier life.

In the new world of the SM&CR, with more whistleblowing taking place, it is more important than ever for firms to be confident that their policies and procedures and systems and controls for the appropriate protection of whistleblowers are adequate and effective. The FCA's guidance on whistleblowing is set out in [chapter 18](#) of its Systems and Controls sourcebook (SYSC) and includes a thinly veiled threat about the potential consequences for firms who do not take these matters seriously enough:



The FCA would regard as a serious matter any evidence that a firm had acted to the detriment of a whistleblower.

Such evidence could call into question the fitness and propriety of the firm or relevant members of its staff, and could therefore, if relevant, affect the firm's continuing satisfaction of [Threshold Condition 5](#) (Suitability) or, for an approved person or a certification employee, their status as such.

(SYSC 18.3.9G)



This consideration is perhaps most important for solo-regulated firms who will become fully subject to the core SM&CR regime in December 2020, and who will therefore be conducting their conduct rules training to their staff over the coming months. For more information, see [Practice note, SM&CR for FCA solo-regulated firms](#).

Reason 2: #MeToo and the “non-financial misconduct” agenda

It is difficult to protect whistleblowers effectively when you are training people from a policy which has an outdated mechanism for identifying whistleblowers. It is therefore important both for firms, and the senior individuals with responsibility for the whistleblower framework, that the systems and controls for the identification (as well as the management) of whistleblower reports are regularly reviewed and updated.

Identifying whistleblowers has been made more complicated by the change in emphasis within conduct regulation in the months since #MeToo hit the headlines, precipitating a keen regulatory interest in what is now called “non-financial misconduct” (for example, bullying and harassment). The FCA has now clarified that it takes non-financial misconduct just as seriously as, for example, market abuse, and that it views instances of non-financial misconduct as having the potential to amount to breaches of **Individual Conduct Rule 1** (“You must act with integrity”), as well as being relevant to the determination of fitness and propriety under the SM&CR. A lesser-commentated fact is that this regulatory policy development has very significant knock-on effects in respect of what firms’ whistleblower frameworks are now expected to cover. Many matters that would previously have been regarded as grievances to be dealt with by HR have now taken on a clear regulatory complexion and require careful, collaborative management by both HR and legal/compliance teams to manage all the relevant risks effectively.

What are the applicable regulatory requirements?

The regulatory requirements apply strictly to UK banks and insurers, and to other firms as guidance (see [Regulatory requirements](#) below). These regulatory requirements overlap in complex ways with general employment law considerations, the Public Interest Disclosure Act 1998, and changes under the EU Whistleblowing Directive ((EU) 2019/1937) which seem likely to be implemented in the UK despite Brexit. This practice note concentrates on the regulatory requirements.

Regulatory requirements

SYSC 18.1.1A-C set out the application of the rules and guidance in SYSC 18 (Whistleblowing) to:

- UK SMCR banking firms (as identified in SYSC 23, Annex 1), except small deposit takers with gross assets of £250 million or less.
- UK Solvency II firms, Lloyd’s of London and its managing agents.
- Other firms, which may adopt the rules and guidance as best practice, tailored in approach in a manner that reflects the firm’s size, structure and headcount.

Since 10 December 2018, there has been an additional requirement on **EEA SMCR banking firms** and **third-country SMCR banking firms** to communicate to their UK-based employees that they may disclose reportable concerns to the PRA or the FCA, and the methods for doing so. This communication to UK-based employees must, in particular, make clear that reporting to the PRA or FCA is not conditional on having first reported the matter internally. This must also be covered in the firm’s employee handbook (SYSC 18.3.6R).

Dual-regulated firms should be aware that the PRA has also made rules relating to whistleblowers (in **2A (Whistleblowing)** of the General Organisational Requirements Part of the PRA Rulebook for CRR firms, and in the **Whistleblowing Part** of the PRA Rulebook for Solvency II firms). The PRA’s rules about whistleblower systems and controls impose equivalent obligations to those that already exist under the FCA rules, but mean that either the PRA or the FCA could take action against a firm (or its senior management function (SMF) holders) for breach of the rules.

CHECKLIST FOR WHISTLEBLOWER FRAMEWORK SIX-STEP REGULATORY HEALTH CHECK

Step 1: Diagnosing whistleblowers effectively

Step 1: Are you diagnosing whistleblowers effectively?

The FCA is actively interested in how firms are quality checking their processes and procedures for classifying complaints as either grievances (which fall outside a firm's whistleblower framework) or reportable concerns (which fall within it).

The HR perspective

The threshold for qualifying as a "protected disclosure" under employment law (specifically, the Public Interest Disclosure Act 1998 and the Employment Rights Act 1996, which give enhanced protection to workers who suffer detriment as a result of making a "protected disclosure" of wrongdoing at their employer firms) is reasonably high. It includes, for example, a requirement that the worker must reasonably believe that the disclosure is in the public interest.

Many firms' whistleblower policies were originally written or commissioned by firms' HR departments, whose primary objectives (understandably) would have been to minimise employment law risk arising from the protection of whistleblowers under relevant employment legislation.

As a result, many whistleblower policies are built primarily around the concept of a "protected disclosure", and so effectively start from the premise that the employment law definition of a whistleblower is the one to work from.

The regulatory perspective

Importantly, though, the regulatory definition of a whistleblower is rather different from the employment law definition.

The Glossary to the FCA Handbook defines a "whistleblower" as "any person that has disclosed, or intends to disclose, a reportable concern".

"Reportable concern" is in turn defined to include "anything that would be the subject-matter of a protected disclosure", but also "a concern held by any person in relation to the activities of a firm, including:

- A breach of the firm's policies and procedures.
- Behaviour that harms or is likely to harm the reputation or financial well-being of the firm."

This definition is significantly broader than the definition of a "protected disclosure" under employment law (see [The HR perspective](#) above), meaning that a person may qualify for regulatory purposes as a whistleblower when they would not qualify for whistleblower protections under employment law.

In addition, the FCA has now made clear that "non-financial misconduct", including bullying and harassment, is capable of breaching regulatory rules (specifically, [Individual Conduct Rule 1](#), which requires individuals to act with integrity). In the FCA's May 2019 paper "[Progress and challenges: 5 Conduct Questions, Industry Feedback for 2018/19, Wholesale Banking Supervision](#)", the FCA stated that:



Non-financial misconduct, such as personal misbehaviour, bullying or sexual misconduct is as important an aspect of conduct as financial misconduct.



In January 2020, the FCA sent a [Dear CEO letter](#) to the CEOs of wholesale general insurance (GI) firms, setting out its expectations for them to be proactive in tackling non-financial misconduct in the sector. The letter explains that, although work has been undertaken in the market to tackle the issue of non-financial misconduct, it continues to be prevalent and will be a key focus for its supervision of firms and of senior managers. The FCA goes on to say (our emphasis):



Clarity of purpose is fundamental to culture. [...] A firm that has a clear purpose is more likely to have clarity of direction and drive the right conduct. We strongly encourage firms to reflect on any inconsistencies between espoused (or implicit) purpose and strategy and business practice, people management and formal governance, systems and controls. **Among other things, we expect firms to have strong whistleblowing processes** and appropriate incentive structures.



It is clear from this that a complaint of bullying or harassment would, in today's world, be capable of being a "reportable concern" from the FCA's perspective, even in circumstances where it may arguably not qualify as a "protected disclosure" for employment law purposes.

The consequence for firms reviewing their whistleblowing policies is that many matters that might previously have been regarded as pure grievances, to be dealt with by HR, could now fall within the regulatory definition of a "reportable concern", and so ought to be investigated (and reported) as whistleblower complaints. This is by no means straightforward to do, especially in situations where a complaint relates to a personal matter such as bullying or harassment, and the complainant has requested that confidentiality be maintained. Such cases require a collaborative effort between HR and legal/compliance teams to ensure that all relevant employment law and regulatory risks are managed effectively.

Another important consequence is that the individuals making disclosures about matters that until recently might have been regarded as HR matters, must now be afforded the protections offered to whistleblowers under the UK regulatory systems (see [Step 2: Maintaining policies and procedures](#) below).

So, firms should start by ensuring that their whistleblower policies and procedures are up-to-date in respect of the identification of whistleblower incidents in the first place.

Step 2: Maintaining policies and procedures

Step 2: Are your whistleblower policies and procedures otherwise up-to-date?

As noted in [Regulatory requirements](#) above, the key obligations imposed upon firms by the FCA in relation to whistleblowing are found in [SYSC 18](#). The rules cover four principal areas, summarised in the sections below.

Procedures

Firms are required to establish, implement and maintain appropriate and effective procedures for the disclosure of reportable concerns by whistleblowers (SYSC 18.3.1R). The procedures must be:

- Able to effectively handle reportable concerns where the whistleblower has requested confidentiality, or chosen not to reveal their identity, and include reasonable measures to ensure that no person under the control of the firm victimises the whistleblower.
- Readily available to the firm's UK-based employees.

In addition, among other things, there should be arrangements for the proper escalation of reportable concerns, as well as providing feedback to the whistleblower (where this is feasible and appropriate).

Firms must also ensure that their processes and procedures reflect the fact that the FCA's rules prohibit them from entering into any settlement agreement with a worker that prevents the worker from making a protected disclosure (SYSC 18.5.1R). For example, firms cannot ask workers to enter into warranties that require them to disclose to the firm that they have made a protected disclosure (SYSC 18.5.3R).

Records and reports

Records must be kept of reportable concerns, together with records of how each disclosure was dealt with by the firm and what the output was. An annual report must be made to the firm's governing body on the operation and effectiveness of its systems and controls in relation to whistleblowing (SYSC 18.3.1R(2)(e) and (f)).

Champion

Insurers, banks and PRA-authorized investment firms must appoint a "whistleblowers' champion" (a non-executive director, if the firm has one) to ensure and oversee the integrity, independence and effectiveness of the firm's policies and procedures on whistleblowing. The role and responsibilities of the whistleblowers' champion are set out in SYSC 18.4.

Confidentiality

The FCA expects firms to have documented and effective processes to prevent breaches of confidentiality that could potentially allow for victimisation of whistleblowers to take place. This has been a high-profile issue where the FCA has made early interventions under the senior managers regime (SMR), focusing on Individual Conduct Rules 1 (Integrity) and 2 (Due skill, care and diligence) (COCON 2.1.1R and 2.1.2R).

Training

Firms must provide training to UK-based employees, managers of UK-based employees (regardless of where the manager is based), and employees responsible for operating certain parts of the firm's whistleblowing arrangements or assisting the whistleblowers' champion (see **Champion** above) (regardless of where these employees are based).

There are certain mandatory components for this training (see SYSC 18.3.4G), including "how to recognise when there has been a reportable concern by a whistleblower". In light of Step 1 of this checklist (see **Step 1: Diagnosing whistleblows effectively** above), it may well be that this section of many firms' existing SYSC 18 training materials needs to be updated to ensure that it properly reflects the FCA's current emphasis on non-financial misconduct.

Step 3: Making required regulatory notifications

Step 3: Are you making the required regulatory notifications in respect of employment tribunal cases involving whistleblowers?

There is a specific FCA requirement that firms must file prompt reports with the FCA about each case the firm has contested, but lost, before an employment tribunal, where the claimant successfully based all or part of their claim on either detriment suffered as a result of making a protected disclosure in breach of section 47B of the Employment Rights Act 1996, or being unfairly dismissed under section 103A of the Employment Rights Act 1996 ([SYSC 18.3.1R\(2\)\(f\)\(ii\)](#)).

In light of the current regulatory focus upon culture and conduct, it is particularly important that firms' internal processes and procedures ensure that such reports are made promptly, as failures in this area are more likely than ever to lead to regulatory action (whether using enforcement powers, or more assertive supervision).

For more information on the FCA's and PRA's approach to supervision, see [Practice notes, FCA supervisory model](#) and [PRA supervisory model](#). For an overview of the FCA's and PRA's enforcement processes, see [Practice notes, FCA enforcement regime: overview](#) and [PRA enforcement: financial penalties, restrictions and suspensions, public censures and settlement of cases](#).

Step 4: Preventing conflicts of interest and "wrong" behaviours

Step 4: Are you doing everything you can to ensure that staff dealing with whistleblower incidents are not faced with conflicts of interest and/or remuneration and performance management structures that risk incentivising them against doing the right thing?

It is essential for the proper resolution of whistleblower complaints that those who are tasked with investigating and responding to such complaints are not put in a position where their personal interests are at risk of influencing the outcome. This may sound obvious, but in practice it can easily happen that the individuals responsible for resolving whistleblower complaints cannot make their decisions entirely objectively.

The most common scenario in which this could occur is that, as the factual investigation unfolds, the individual(s) investigating the matter become implicated in the complaint. This situation can give rise to a conflict of interest at the individual level, and so it is important that firms' policies and procedures for the investigation of whistleblower complaint state clearly that any person investigating a whistleblower complaint who is subsequently implicated in that complaint, must be removed from the matter immediately.

However, conflicts of interest can also manifest themselves in more indirect ways. The FCA is becoming increasingly focused, in other contexts, on the importance of sound performance management processes in securing the right outcomes for firms and their customers. See, for example, a March 2017 [speech](#) on culture in financial institutions by Andrew Bailey, the former FCA Chief Executive, in which he identified performance management as one of the key "drivers" of firms' culture, saying:



It is for firms to identify the drivers of behaviour within the firm and control the risks that these drivers create.



If the way in which individuals' performance is assessed within a firm is at risk of driving the "wrong" behaviours from the FCA's perspective, it is very unlikely the firm will be able to comply fully with the FCA's regulatory expectations. For this reason, it is not surprising that the FCA is now becoming increasingly focused on how firms manage the performance of their staff and, specifically, of the specific teams who are responsible for handling whistleblower complaints.

Firms would do well to scrutinise the performance management frameworks and practices applicable to their staff with responsibility for handling whistleblower complaints, in order to stay abreast of the FCA's expectations in this area.

Step 5: Conducting root cause analysis

Step 5: Are you conducting root cause analysis that will allow the firm to learn lessons for the future?

No firm is perfect, but the UK financial services regulators place great emphasis on the ability of firms to respond effectively to issues that have been identified, to prevent the same problems from recurring in the future.

In addition, in other contexts, the FCA is prescriptive about the need for firms to conduct root cause analysis of complaints, in order to identify and remedy any recurring or systemic problems. For example, in the FCA's detailed guidance to firms handling payment protection insurance (PPI) complaints at [DISP App 3.4](#), the FCA includes the following guidance on how in practice firms should use their root cause analysis:



Where a firm identifies (from its complaints or otherwise) recurring or systemic problems in its sales practices for a particular type of payment protection contract, either for its sales in general or for those from a particular location or sales channel, it should (in accordance with Principle 6 (Customers' interests) and to the extent that it applies), consider whether it ought to act with regard to the position of customers who may have suffered detriment from, or been potentially disadvantaged by such problems but who have not complained and, if so, take appropriate and proportionate measures to ensure that those customers are given appropriate redress or a proper opportunity to obtain it. In particular, the firm should:

- (1) ascertain the scope and severity of the consumer detriment that might have arisen; and
- (2) consider whether it is fair and reasonable for the firm to undertake proactively a redress or remediation exercise, which may include contacting customers who have not complained.



Similarly, with whistleblower complaints, while this is not (yet) prescribed by any rule, it is important as a matter of good risk management practice for firms to conduct a regular analysis of the possible root causes of any recurring themes emerging from their whistleblower complaints.

For example, the FCA will expect firms to monitor any complaints from whistleblowers about the whistleblowing process and its outcomes and consequences. Firms that do this, and (perhaps more importantly) can show they are actually acting on their root cause analysis by making changes to the ways they operate day-to-day, will be in a much stronger position if they are ever challenged by the regulator in relation to the volume of whistleblowing complaints they receive.

Following this practice will also be important for those members of senior management who have specific responsibility for the firm's whistleblower framework, to demonstrate that they are discharging their responsibilities in that area effectively.

Step 6: Embedding a culture of psychological safety

Step 6: Does the volume of whistleblows your firm receives indicate that senior management need to do more to embed a culture of “psychological safety” within the firm?

During 2019, it was becoming increasingly clear that the FCA was shifting its expectations of firms with the effect that having robust frameworks for dealing with whistleblower complaints was no longer sufficient. Rather, the FCA now expects firms to seek to foster a culture of “psychological safety” whereby workers feel able to raise concerns directly to their line managers, rather than feeling the need to go through whistleblowing channels (whether internal or external).

For example, in February 2019, the FCA published a [webpage](#) devoted to the subject of psychological safety as part of its “culture and governance” cross-sector focus. The FCA has referred in many speeches since then to the concept of psychological safety, and the associated concept of creating a “Speak up, Listen up” culture.

To be clear, creating an environment of psychological safety is different from creating an environment where whistleblowers are safe from retaliation. In emphasising the need for firms to create a “psychologically safe” environment, the FCA is envisaging a post-SYSC 18 world where there is no need for whistleblower frameworks, because everyone feels safe raising issues with their own line manager.

This focus area is no longer confined to the FCA. The PRA has recently indicated that it, too, has been convinced of the need for firms to do more to ensure that they provide a “psychologically safe” environment in which people can raise concerns (including concerns about potential financial weaknesses at the firm that could undermine it from a prudential perspective). In a November 2019 [Dear CEO letter](#) to Chief Executives of general insurance firms regulated by the PRA, the PRA referred to the need for some firms in the sector to improve aspects of corporate culture and individual behaviour. It noted that instances of non-financial misconduct:



... also raise broader questions about whether firms are promoting a culture where staff feel able to speak up about poor practices or unidentified risks within their organisations, including issues relating to a firm’s financial soundness. We remind boards that they have a collective responsibility for articulating and maintaining a culture of risk awareness and prudent management of risk for their organisations.



The upshot of this development is that, in today’s regulatory environment, it may no longer be good enough to have 100%-compliant whistleblower frameworks. Indeed, having a high incidence of whistleblower reports may now be viewed as an indicator that the firm lacks the culture of “psychological safety” that the FCA and PRA now view as a necessary hallmark of a healthy culture.

This is a moving of the goalposts by the UK regulators that arguably necessitates a wider review of a firm’s culture and leadership behaviours, rather than a narrowly-focused health check of its whistleblower framework (although, until such time as the [SYSC 18](#) rules change, firms will need to continue to do that too).

So, the final step of this six-step whistleblower framework health check is, having ensured that your whistleblower framework is in good shape, to widen your perspective and look beyond the

whistleblower framework itself, asking the question whether or not your organisation is one where there is sufficient “psychological safety” that people feel able to raise concerns without blowing the whistle.

For example, you could conduct an employee survey or other review of the culture of your organisation. This will be the first step towards being able to assess how prepared you are as an organisation to move, as the FCA and PRA are indicating that you should, beyond a position where you rely on your whistleblower framework for people to be able to raise concerns, and towards a position where you no longer need it.

Reproduced from Practical Law with the permission of the publishers. For further information visit www.practicallaw.com.

GET IN TOUCH



Polly James

Partner

Litigation and Corporate Risk

T: +44 (0) 20 3400 3158

polly.james@bcplaw.com

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

London

Adelaide House, London Bridge
London EC4R 9HA England

Polly James

Tel: +44 (0) 20 3400 3158

polly.james@bclplaw.com