

Under the microscope: Managing non-financial misconduct in a regulated environment

Lorren Martin, Counsel, and John Bracken, Senior Associate, at Baker & McKenzie LLP explore the issue of non-financial misconduct in UK financial services firms, and how best to manage the potential risks

As regulators continue to point the spotlight on non-financial misconduct and talk of increased enforcement action, regulated firms need to ensure their practices for dealing with this type of behaviour are robust and transparent. In this article, we consider why this is seen as a key area of focus for regulators, what firms can do to ensure they are prepared and how to investigate these types of matters in practice.

What is non-financial misconduct and why are regulatory cracking down on it?

The term "non-financial misconduct" is generally used to refer to inappropriate behaviour within a financial services firm which does not directly relate to the firm's financial business activities. Instead, this usually relates to individual actions by those within the firm which is in breach of firm policy or is considered to have a significant impact on the integrity or reputation of the firm. Examples often include bullying, harassment (including sexual harassment), discrimination or other behaviour which creates a hostile working environment.

This type of behaviour is particularly important to regulators within the financial services industry for a number of reasons. First, it is seen as an indicator of poor culture within the firm. Research has suggested that where there is a poor culture, there is likely to be an increased risk of poor decision making and/or the permission of activities which are in breach of regulatory standards. Culture is therefore not only critical to ensuring a positive workplace for those engaged in financial services firms, but also to ensuring that the actions of the firm and the way they conduct business is lower risk and in accordance with regulatory expectations.

Regulators have also emphasised that the importance of creating speak-up cultures within firms is a vital part of the regulatory framework. This allows individuals to call out any concerning behaviour and to ensure that action can be taken to rectify issues or minimise risks directly. However, this type

of self-regulation only works in an environment where all individuals within the firm, whether in regulated roles or otherwise, feel comfortable to raise issues and are confident they will not suffer retaliation for doing so. Ensuring a supportive working environment where non-financial misconduct is not tolerated is critical to creating this type of culture.

Furthermore, a key focus for regulators is ensuring the reputation and integrity of the financial services system. This has clearly been a challenge over a number of years and the drive to deal with non-financial misconduct is the next step for regulators seeking to tackle this issue. Dealing effectively with those who are not acting with integrity or are otherwise doing things which could lead to a lack of trust in the industry as a whole is therefore a key regulatory issue and high on the agenda. This is particularly important where concerns relate to Senior Managers or other organisational leaders, whose behaviours are seen to set the tone in terms of what is considered acceptable for the organisation as a whole.

What can and should firms be doing?

It is clear from the FCA and PRA consultation on Inclusion and Diversity that firms are now expected to do more to identify and address non-financial misconduct. This was further reinforced by the Sexism in the City Treasury Committee Report which stated that "The era of impunity for perpetrators of sexual harassment and bullies must now end". There are a number of factors which firms should consider in this context to ensure that they are sufficiently prepared to deal with the issues as well as the increased regulatory scrutiny in this area:

Internal policies and procedures

Ensuring there are appropriate and robust internal policies and procedures for dealing with non-financial misconduct is key and HR/ER teams across the industry will need to take the lead on ensuring these are reflective of the

standards of behaviour the firm considers acceptable. First and foremost, this will help to ensure that when non-financial misconduct is identified, it is dealt with and managed efficiently. In addition, this will be important in ensuring that all employees are aware of the behavioural expectations of the firm and the types of consequences which may be applied if they fail to meet those expectations. Furthermore, in the light of the increased focus from regulators, it will be important for firms to be able to demonstrate the systems and controls they have in place to both prevent and deal with this type of misconduct when it arises.

Record keeping

There is a clear move towards greater transparency in this context with regulators wanting to have more visibility over how non-financial misconduct is dealt with by firms, as evidenced by the recent survey conducted by the FCA which requested detailed information in this context. The need for accurate and thorough record keeping is therefore becoming even more paramount. Taking the issue of where a grievance is raised for example, many firms will already keep records of the issues raised in the grievance and whether the allegations were upheld or not. However, often the outcome of a grievance process can be more nuanced – recommendations for training or workplace mediation may be provided but records showing that these have been followed through and completed are often less systematic.

Furthermore, firms will want to ensure they are confident that the recommendations have addressed any issues identified – completing training for example should not be seen as a "tick box" exercise. It will also be important

to ensure that stock is taken after any such recommendations have been completed to ensure that the firm is satisfied that the issues have been addressed. Being able to actually evidence all of these points to regulators is likely to become even more important going forward as the focus

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on dealing with non-financial misconduct continues.

Proactive intervention

In order to best address the regulatory concerns in relation to non-financial misconduct, firms need to consider how they can best identify this type of behaviour at an early stage. It has been common for many years to monitor communications within firms and a review of the mechanics of these systems to consider adaptation to look for both financial and non-financial misconduct may be needed. The use of AI in this context in order to predict the types of behaviour which may be demonstrated by individuals in the light of the content of their communications may also be helpful in identifying higher risk areas of the business where more attention should be focused.

This type of surveillance is not without risk as, whilst firms will need to inform employees that it is being undertaken, there will be a desire to keep the underlying systems confidential to avoid individuals circumventing the monitoring. It is also challenging from a data protection perspective and firms will need to ensure an appropriate risk assessment has been completed, balancing the rights of individuals against the needs of the firm. However, in the current regulatory environment with increased scrutiny in this area, it will not be sufficient for firms to sit back and wait for issues

to be raised – regulators expect risks to be minimised in advance and thought therefore needs to be given to how these issues can best be identified.

There is also an increased focus on HR/ER teams being able to appropriately track the behaviours within teams and address them accordingly. Ensuring there are appropriate systems to flag for example where issues are repeatedly raised about the same person, or where the same type of issue is being raised on a wider firm basis rather than within a particular team will be important. In those circumstances, proactive steps to address the relevant behaviour before it leads to a formal concern being raised should be taken.

Firms should also consider more proactive implementation of their speak-up policies and procedures, with a view to ensuring that a culture of challenge and a working environment where different views are appreciated is maintained. For example, it may be appropriate to consider increased levels of surveillance for individuals who have raised concerns if it is considered that there is a risk of retaliation from others. The promotion of diversity and inclusion is also a driver for better culture and should continue to be an area of focus for firms.

Consistency of sanctions

Firms may also need to review the processes and procedures they currently have in place in order to ensure that they have a strong framework for decision-making, in particular in relation to issues such as conduct rule breaches, malus and clawback, and the content of regulatory references. It can be difficult to assess non-financial misconduct against financial misconduct when considering whether any sanctions imposed are of a comparable level, so firms will need to ensure that there is clear oversight in this context. In addition, it will be important to ensure that there are consistent protocols for involving compliance teams in order to assess the need to report matters to regulators for both financial and non-financial misconduct matters.

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What issues to consider when investigating non-financial misconduct?

Non-financial misconduct can manifest in lots of different forms and, in many senses, investigating issues arising from alleged non-financial misconduct is no different to investigating any other type of workplace issue. Indeed, as the FCA made clear in its "Notice to Provide Information" letter on 6 February 2024, "non-financial misconduct is misconduct and not an additional principle". The starting point for any investigation into non-financial misconduct should therefore involve the internal policies

and procedures that would govern any relevant internal process: what does the disciplinary and grievance procedure look like? What protections and controls are in place to manage a whistleblowing complaint? Which policies may have been breached by the alleged conduct?

This early engagement will ground the investigation in basic principles of procedural fairness, ensuring that any investigation is approached with an eye to consistency with standard internal procedures. This being said, whilst at a cosmetic level a non-financial misconduct investigation may look the same as any other workplace investigation, there are pressure points to consider before, during, and after this type of investigation resulting from the unique regulatory environment and the enhanced scrutiny that financial services firms currently face.

Understanding the issue and your objectives

To ensure firms are fully prepared to deal with these pressure points if and when they arise, the first step is to clearly understand the nature

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of the complaint or allegation and establish the objective of any proposed investigation. Different types of non-financial misconduct, such as harassment or discrimination, may require tailored approaches, so understanding the details is crucial. Thinking about the product of the investigation at the outset is also a crucial early step and will serve to inform the nature, purpose, and scope of an investigation.

Non-financial misconduct can be an indicator of wider

cultural issues. It is helpful to consider whether the complaints are specific or whether they go to broader issues relating to corporate governance and culture. If the latter is the case, a culture audit may be necessary instead of or in addition to a more personal investigation into allegations against particular individuals.

Who is your investigation and advisory team?

Having regard to the sensitivity and complexity of the allegations, it is also important to think about who is best equipped within or outside of the firm to manage the investigation as early as possible.

Is the investigation suitable for an internal ER team to manage or are there legal complexities or internal dynamics that require a third-party investigator, such as an external

lawyer? If so, are your existing legal advisers appropriate or should a fully independent third-party investigator be engaged? Some high-profile recent matters where panel law firms have investigated matters on behalf of their clients were called out in a recent *Financial Times* article, with resulting investigations being labelled a "whitewash". It will therefore be important to think carefully about what this perception might mean for the integrity of any investigation findings. Firms who are proposing to engage existing advisers while also simultaneously seeking legal advice on the implications of the investigation will need to ensure the relevant advisers are taking necessary steps to put in place a robust ethical wall with clean advisory and investigation teams.

What other advisers or subject matter experts might need to be involved in the investigation? This may include regulatory advisers, local lawyers if there is a cross-jurisdictional element to the complaint, forensic experts to assist with document collation and review, or a communications / public relations team if there is a chance of media coverage and reputational issues are at stake.

Vulnerable or reluctant witnesses

Investigations into non-financial misconduct often involve sensitive issues that can be emotionally charged, with sometimes reluctant witnesses or decision-makers. It is important to handle these matters with care, ensuring that appropriate guardrails are in place to encourage transparency within an interview and to protect the veracity of the information given.

Building trust – particularly with reluctant witnesses – is vital in gaining cooperation. This is a reminder as to why selecting an appropriately experienced investigator is important, as well as having in place the necessary policies and procedures to protect the confidentiality of relevant processes.

Firms should also clearly communicate the support measures, such as employee assistance programmes, counselling, or the use of a companion or other adjustments that may be available to encourage participation.

In some circumstances, it may be necessary to remind employees of their obligations under firm policies and the potential consequences of non-cooperation.

Regulatory issues

Reputation can be tarnished in the public eye, but it can also be tarnished with regulators, so a financial services firm subject to external regulatory controls may need ongoing notifications to a regulator. Constructive dialogue with a regulator is key in ensuring transparency but, conversely, firms must also ensure that the investigation plan is robust enough to resist any direct or indirect regulator pressure as to the conduct or outcome of the process.

The added scrutiny of a regulator may have implications for the willingness of a potential wrongdoer or witnesses to get involved. In the most serious cases of non-financial misconduct, a potential outcome may be summary dismissal with the need for a resulting disclosure on a future regulatory reference, identifying disciplinary action taken and associated breaches of relevant Conduct Rules or findings that go to an individual's fitness and propriety.

For that reason, often an alleged wrongdoer will simply not want to take the risk of such a finding and will instead decide to retreat and obfuscate. Whereas previously such a refusal may have ultimately resulted in an agreed resignation or mutual exit, the increased focus on non-financial misconduct and obligations of firms in terms of the content of future regulatory references means that firms cannot "turn a blind eye" when such issues arise, so commercial settlements in these types of situations are no longer a substitute for a robust investigation process.

Criminal issues

If the non-financial misconduct complained of may also amount to a criminal offence, this brings with it a further layer of complexity and challenge. Firms need to understand the context and nature of the allegations and consider the impact of any criminal

law requirements, even for apparently minor offences. In addition to any workplace investigation, firms may be required to liaise with the police or other external agencies, all the while seeking to manage a fair procedure that may be complicated by questions of timing and control of the investigation.

Questions which may need to be addressed when the police are involved include: What if a criminal investigation is going to take months or years, can you wait that long (particularly with the spectre of a regulator in the background)? What if the police specifically ask you to put an investigation on hold as they are concerned about contamination of evidence or witnesses? What action are you prepared to take if an employee refuses to engage because they are concerned any internal investigation might prejudice criminal proceedings?

It goes without saying that, in such a case, there may also be serious reputational risks that will need to be considered, so a proactive press strategy may also be required in tandem.

Conclusion

Conducting an investigation into non-financial misconduct is a complex and sensitive process that requires careful planning, execution, and follow-up to ensure that issues are addressed in a way that is capable of withstanding regulatory scrutiny. Early engagement with the allegations, adhering to an agreed investigation plan, and ensuring that the right investigators and advisers are involved at all stages, will help to ensure fairness and thoroughness throughout the process.

In conjunction, a clear communications plan, with the regulator, press, or external agencies, is vital. In doing so, firms can demonstrate that effective steps are in place to address non-financial misconduct and foster a positive, respectful workplace culture, which is ultimately the goal that underpins the recent increased regulatory focus in this area.

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