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Sent by email: [dp16-4@fca.org.uk](mailto:dp16-4@fca.org.uk)

4 January 2017

Dear Sir or Madam,

**Re: FCA Discussion Paper DP16/4, “Overall responsibility and the legal function”**

The Alternative Investment Management Association<sup>1</sup> (“AIMA”) and Managed Funds Association (“MFA”)<sup>2</sup> welcome the opportunity to provide comments to the Financial Conduct Authority (the “FCA”) on its Discussion Paper<sup>3</sup> relating to application of the Senior Managers Regime (SMR) to the legal function (the

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<sup>1</sup> AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,700 corporate members in over 50 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides. Providing an extensive global network for its members, AIMA’s primary membership is drawn from the alternative investment industry whose managers pursue a wide range of sophisticated asset management strategies. AIMA’s manager members collectively manage more than \$1.5 trillion in assets.

<sup>2</sup> The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

<sup>3</sup> See <https://www.fca.org.uk/publication/discussion/dp16-4.pdf>.

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“Discussion Paper”). Our interest in the proposals reflects the interest of our members – both large and small – in how the SMCR regime evolves ahead of its extension to asset managers and other investment firms in 2018.

Overall, AIMA and MFA do not consider it appropriate to include the management of the legal function in the SMR. In our view, its inclusion would create unjustified difficulties and conflicts, particularly when the responsibility falls to the relevant firm’s General Counsel (and in this regard, a number of our members’ concerns will also be represented by the Law Society’s response to the Discussion Paper). In particular, we question whether, in practice, the statutory protections cited by the FCA in the Discussion Paper (*e.g.* Section 413 of the FSMA) will be sufficient; if a firm is under enquiry involving the legal function, in order to avoid the reputational damage of a formal investigation, the firm may feel under pressure to waive legal professional privilege, regardless of the statutory protections. Furthermore, while we consider the new Individual Conduct Rules to be reconcilable with the head of the legal function’s professional ethical and conduct obligations, we are concerned that the additional requirements under the SMR would fundamentally undermine the independence of the legal function. In our view, the cumulative impact of these issues will likely diminish the business’s willingness to seek open and frank legal advice from in-house counsel – potentially having a knock-on effect on the firm’s overall understanding of what it should prudently and sensibly do in a legal and risk management context.

In our view, it is relevant to reflect on the history of the development of the in-house legal function in firms. Whereas previously, large organisations may have accessed external counsel for their legal advice, the growing complexities of modern business have resulted in firms achieving improved economies by developing legal services in-house. Despite the shift, it is imperative that the lawyer/client relationship is maintained to ensure that the business is able to obtain full, frank and independent legal advice without fear that communications will need to be disclosed. In our view, equivalent risks do not arise in relation to inclusion of management of other internal-facing functions such as Human Resources and information technology.

In the event that responsibility for the management of the legal function is included in the SMR, we would urge the FCA to take a very cautious approach and provide clear guidance to industry on the boundaries and practical application of the rules to the senior manager responsible for managing the legal function, including:

- the reasonable steps expected of the person managing the legal function to discharge their duty of responsibility;
- clarity on the protections for privileged communications, including: (i) a clarification to Rule 4 of the Senior Manager Conduct Rules to reflect the guidance in COCON 4.1.12G on the interaction between the SMR and legally privileged information; and (ii) confirmation that no adverse inferences, either against the relevant firm or its General Counsel, will be drawn from non-disclosure of privileged information; and
- the establishment of a clear distinction between management of the legal function and the provision of legal advice, including addressing practical examples where this might become blurred to establish clear expectations.

On this last point, it would be particularly useful to understand how the FCA envisages managers might distinguish between privileged communications and the operational management of the legal function in practical scenarios. For example, a General Counsel’s operational assessment of whether an in-house lawyer has sufficient skills and experience to advise the business on a particular legal issue will be based



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on, and therefore difficult to separate from, the specifics of the request for legal advice, which will be privileged.

On the whole, our members are of the view that the erosion of legal professional privilege and the independence of the legal function far outweighs the benefits of inclusion of responsibility for overall management of the legal function in the SMR. In the event that the FCA follows this course, AIMA and MFA strongly recommend that the FCA provides industry with detailed guidance to address these practical issues and ensure firms have clarity on where the line between legal advice and operational management will lie, and have comfort regarding their ongoing reliance on legal professional privilege to maintain access to unhindered legal advice to support the business.

We hope you find our comments useful and would be more than happy to answer any questions you may have in relation to this letter. Please do not hesitate to contact Adele Rentsch ([arentsch@aima.org](mailto:arentsch@aima.org)) or Adam Jacobs-Dean ([ajacobs-dean@aima.org](mailto:ajacobs-dean@aima.org)) or Benjamin Allensworth ([ballensworth@managedfunds.org](mailto:ballensworth@managedfunds.org)) or Stuart Kaswell ([skaswell@managedfunds.org](mailto:skaswell@managedfunds.org)) in relation to the issues raised in this letter.

Yours sincerely,

/s/ Jiří Król

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/s/ Stuart J. Kaswell

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