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Financial Services Risk and Regulation

Hot topic

Extending the Senior Managers and Certification Regime

Highlights

The FCA and PRA propose to extend the SM&CR to all FCA firms, and to amend the existing insurance and banking regimes.

Governance and culture are a key priority for the regulator. The regimes will replace the existing Approved Persons Regime, and seek to drive individual accountability in senior staff.

The FCA and PRA want to conform their approach to governance and accountability in financial services by extending the Senior Managers Regime (SMR) and Certification Regime (CR) (together SM&CR) to all FCA regulated firms. The regulators are also seeking to align the existing Senior Insurance Managers Regime (SIMR) for insurers with these new proposals.

The FCA and PRA set out their proposals to extend the SM&CR in three consultation papers: CP17/25 "Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms"; CP17/26 "Individual Accountability: Extending the Senior Managers & Certification Regime to insurers"; and CP14/17 "Strengthening individual accountability in insurance: extension of Senior Managers & Certification Regime to Insurers". These were released together on 26 July 2017.

As well as setting out the new SM&CR regime for FCA-only regulated firms, the regulators propose extending the CR to insurers, and some amendments to the existing banking and insurance SMRs.

The proposals are set to impact approximately 50,000 FCA solo regulated firms, which comprise a diverse group of financial services businesses. The FCA therefore proposes a proportionate approach, with differing requirements for various types of firm. Through a three-tiered approach to applying SM&CR, it targets firms based on their complexity and risk to the financial system.

The 350 largest asset managers, intermediary firms, credit firms and non-bank lenders will be subject to the 'enhanced regime', which is most similar to the existing SM&CR.

Other firms will either benefit from the lighter 'core regime', with baseline requirements, and a few firms (such as sole traders, internally managed AIFs, professional and non-core FS firms) will be considered limited scope firms and experience the 'limited regime'. Appointed representatives are currently out of scope.

The FCA and PRA welcome responses to their consultations until **3 November 2017**. The FCA expects to publish a technical consultation, which will consider transitional and grandfathering provisions, and then final rules in 2018.

Senior managers: core regime

As with the existing SM&CR regime for banks and insurers, the SMR elements will apply to the most senior staff in an organisation. While the exact application will depend on firm type, size and complexity, the regulator's aspiration is to make senior staff individually accountable for the firm.

To achieve this, firms must allocate specific 'prescribed responsibilities' (PRs) to senior managers (SMs). All SMs will need to document their areas of responsibility through individual 'statements of responsibility', akin to regulatory role descriptions. These must be kept up-to-date as individuals, roles or firms' strategies change. Typically, PRs must be allocated to one individual, and not split or shared across multiple SMs.

SMs will operate under a duty of responsibility. If a problem occurs in an area of their responsibility, the FCA will consider whether 'reasonable steps' were taken in the discharge of their responsibilities. This has presented operational and philosophical challenges for firms, as the accountability and responsibility falls squarely on an individual. As part of the implementation process, firms must consider the impact on their people, who have been keen to consider how best to demonstrate reasonable steps.

SMs will need to be pre-approved by the regulator before appointment, in a similar way to individuals currently subject to the FCA's Approved Persons Regime. This may include interviews and vetting and firms will need to conduct criminal records checks.

The FCA's technical consultation paper will consider the transitional arrangements in more detail, although grandfathering of existing individuals is expected, particularly given the volume of individuals involved.

Firms will also be required to comply with a regulatory references regime which mirrors the approach in the SM&CR for banks.

Senior staff captured by the SMR include:

- SMF9 – Chairperson
- SMF1 – Chief Executive
- SMF3 – Executive Director
- SMF27 – Partner Required functions
- SMF16 – Compliance Oversight
- SMF17 – Money Laundering Reporting Officer (MLRO)

Many of the PRs will be familiar to or self-explanatory to firms, such as the PR to ensure 'performance by the firm of its obligations under the Certification Regime'.

But as highlighted by the FCA in its recent Asset Management Market Study (MS), one PR (which must be allocated to the Chair of the Authorised Fund Manager) is to accept 'responsibility for an AFM's value for money assessments, independent director representation and acting in investors' best interests'. This, as phrased, is a wide responsibility to effectively ensure compliance with a significant portion of the MS's remedies, and will be of particular note to firms with relevant funds.

Senior managers: enhanced regime

Firms will be subject to the enhanced regime if they meet any of the six criteria set out as:

- a Significant IFPRU firm
- a CASS Large firm
- firms with Assets Under Management of £50 billion or more (at any time in the previous three years)
- firms with current total intermediary regulated business revenue of £35 million or more per annum
- firms with an annual regulated revenue generated by consumer credit lending of £100 million or more
- mortgage lenders (that are not banks) with 10,000 or more regulated mortgages outstanding.

Limited scope firms and EEA and non-EEA branches will not be moved into the enhanced regime even if they meet any of the above criteria.

For firms in the enhanced regime, the SMR will apply most broadly to senior staff. In addition to the core list of roles and PRs, enhanced firms may also need additional roles and will have additional PRs to allocate. The additional roles include:

- SMF2 – Chief Finance Function
- SMF4 – Chief Risk Function
- SMF5 – Head of Internal Audit
- SMF14 – Senior Independent Director
- SMF12 – Chair of the Remuneration Committee
- SMF10 – Chair of the Risk Committee
- SMF11 – Chair of the Audit Committee
- SMF13 – Chair of the Nominations Committee
- SMF24 – Chief Operations Function
- SMF7 – Group Entity Senior Manager: Someone who has significant influence on the management or conduct of the affairs of the UK-regulated entity and is employed by, or is an officer of, another member of its group.
- SMF18 – Other Overall Responsibility

Enhanced firms will also need to consider on a firm-by-firm basis whether there are additional individuals not caught as an SM, but who do have an overall responsibility for a key area, business activity or management function of the firm.

Operationally, in addition to individual statements of responsibility, firms must create and maintain a 'responsibilities map' setting out the interaction of the PRs, and interaction with wider governance structures. SMs in enhanced firms will also need to consider handover procedures and materials.

There is no territoriality limitation on the SMR, so an SM performing a role overseas would still remain in scope. Often a SM will hold more than one PR, relevant to their role.

Senior Managers: limited scope firms

For limited scope firms (sole traders, ancillary FS firms), the number of SMs maybe a low as one.

While they will transition into the new SM&CR, it will be a similar approach to the current Approved Persons Regime. A small sole-trader may only have the new SMF16 compliance oversight role; others may require the SMF29 limited scope function which is similar to the Apportionment and Oversight Function under the Approved Persons Regime.

Certification regime

The CR applies to those individuals able to cause significant harm to the firm, or its customers. This includes the following roles and the entire line of management above these individuals, up to but excluding the SM, as individuals cannot be both SMs and in the CR.

- significant management function
- proprietary traders
- CASS oversight function
- functions that are subject to qualification requirements (such as mortgage advisers, financial advisers)
- client dealing function
- algorithmic traders
- material risk takers.

Under the current Approved Persons Regime, some of these roles are pre-approved by the FCA. But the FCA will no longer approve these individuals as it believes that the objective of the CR is to shift responsibility for assessing fitness and propriety to firms. So under the SM&CR, responsibility for approving and then assessing the ongoing fitness and propriety falls solely on the firm. An SM will be personally accountable for this, and will need to certify annually that all staff are fit and proper.

Firms will need to provide regulatory references for all SMs and staff in the CR.

For UK firms, the CR is limited to those performing a certification function who are either based in the UK or, if based outside the UK, are dealing with UK clients.

For both non-EEA and EEA branches, the CR will only apply to those individuals in the UK. If people are dealing with UK clients from abroad, the CR will not apply.

Conduct rules

Conduct rules will apply very broadly to almost all staff in a firm, including SMs, those in the CR and all other staff. The conduct rules will replace the existing Statements of Principle and Code of Practice for Approved Persons in the FCA handbook.

Five conduct rules will apply to all staff. They are:

1. You must act with integrity
2. You must act with due care, skill and diligence
3. You must be open and cooperative with the FCA, the PRA and other regulators
4. You must pay due regard to the interests of customers and treat them fairly
5. You must observe proper standards of market conduct

In addition SMs have four further rules:

- SC1. You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively
- SC2. You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system
- SC3. You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively
- SC4. You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice

Excluded staff are limited to a specific list of ancillary roles such as receptionists, drivers, security and medical staff.

The FCA is seeking to apply the conduct rules to a firm's regulated and unregulated financial services activities where they are carried on in connection with a regulated activity. This is narrower than the requirements under the SMR for banks, where the conduct rules apply to everything someone does on behalf of a banking firm.

Firms must train staff to understand how the conduct rules are relevant to their individual roles. An SM will be personally responsible for ensuring compliance with this.

Additionally, firms must report disciplinary action taken due to a breach of the conduct rules to the FCA. This must be completed within seven days for SMs, and on an annual basis for all other staff.

Insurers

The FCA and PRA want to align the SIMR with the existing SM&CR. The regulators propose a number of changes including:

- the creation of a new CR that mirrors the extended CR regime for FCA firms and existing banks
- widening the scope of the conduct rules to cover a broader range of individuals
- introducing a proportionate SM&CR regime for firms outside the scope of Solvency II
- introducing a number of new FCA Senior Manager Functions (SMF)
- introducing a duty of responsibility in relation to regulatory breaches
- introducing a number of new PRs (including four new PRs for third country branches and Swiss general insurers)
- adding a new rule relating to the provision of handover information for an individual to perform or take over an SMF
- facilitating the approval process for transfers of individuals between banking and insurance firms.

The introduction of the CR will mean that all individuals previously designated as Key Function Holders or who are considered material risk takers will need to be certified as fit and proper on an annual basis. Non-Executive Directors will be excluded from this requirement in addition to individuals who have been approved for a SMF.

There will also be a number of minor changes in order to align the accountability regimes such as renaming Senior Management Insurance Functions as SMFs; renaming the existing 'scope of responsibilities statements' as 'statements of responsibilities' and replacing 'governance maps' with 'responsibilities maps'.

Both the FCA and PRA request responses to their consultations on the changes to SIMR by 3 November 2017.

Banking amendments

The FCA is creating an additional PR which will apply to all firms, including banks. This is to ensure that all staff have been trained in the conduct rules.

The FCA also proposes extending the new SMF27 Partner role to banks, although isn't aware of any banking institution structured as an LLP.

What do I need to do?

- Firms need to engage with the FCA, and PRA where appropriate, in response to the proposals. With such a diverse range of firms impacted, it is important that firms consider the implications for their business and engage with the regulator where appropriate.

- The very nature of the SM&CR is personal to individuals, and can be emotive. Good initial and ongoing communications with staff are important.

- Firms should consider the interaction with wider existing governance and procedures in their implementation plans. For firms with a non-UK parent or establishments, understanding the extraterritorial implications is also important.

If you would like to discuss any of the issues outlined in this paper, please speak to your usual PwC representative or one of contacts below.

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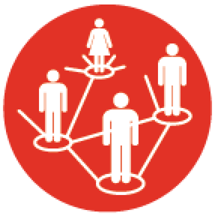

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