

Senior Managers And Certification scheme – Where Are We?

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**COMPLIANCE
CONSULTANT**

020 7097 1434

info@complianceconsultant.org

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Senior Management & Certification Regimes

Where Are We?

Background

The banking crisis of 2008 exposed significant and exceptional shortcomings in bank's governance and the unethical culture and behaviours which underpinned it. Wind forward to June 2012 when the Parliamentary Commission on Banking Standards (PCBS) was established to consider the professional standards and culture of the UK banking sector and report on lessons to be learned. This was the start of the new regime plans.

The PCBS fundamentally concluded that a lack of proper accountability contributed to the mismanagement of key risks that crystallised and ultimately led to the failure of public trust in the industry. The PCBS made a number of recommendations regarding improving individual accountability in the banking sector which were then incorporated into the Financial Services (Banking Reform) Act 2013 (henceforth stated as the "Act").

The Act made significant amendments to the Financial Services and Markets Act 2000 (FSMA) and, in response, the newly formed regulators, the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) released a joint consultation (FCA CP14/13 and PRA CP14/14) at the end of July 2014 with their specific proposals for creating a new regulatory framework to encourage individuals to take greater responsibility for their actions. The further intention was to make it easier for both firms and regulators to hold individuals to account. The proposals were made applicable to UK banks, building societies, credit unions and PRA-designated investment firms.

Simultaneously the FCA and PRA also released a joint consultation on the implementation of new remuneration rules (FCA/PRA CP15/14) which seeks to introduce changes to remuneration structures. Jointly the two consultations were seen by the regulators as a package designed to reinforce the trend of greater responsibility and accountability across the industry, regaining the public trust over time.

Recently the industry has seen a marked increase in direct intervention by regulators and a move to a more 'intensive' approach to supervision. Additionally, the role and responsibility of the compliance Officer has increased, but notably this has included CEOs, chairmen and boards being asked to provide written attestations and representations of compliance with regulatory standards. This new framework, with its emphasis on individual accountability for both senior individuals and for a wider range of employees, is the culmination of this trend.

The regulators set out in their consultation papers that they expect the new framework to become an integral part of their approach to Authorisation, Supervision and Enforcement. This means that they will look to ensure that key individuals have clear roles and responsibilities throughout their careers. Probably the main and serious message that firms and individuals should take from this is that regulators will expect greater levels of individual accountability from more people across the industry than ever before. As well as increasing the regulatory burden on firms and individuals in 'steady state', the need to adapt to this new regime may catch out those firms which are constantly playing "catch-up" with the regulations due to lack of strategy or for some other reasons may not be properly prepared.

The following table provides the general mapping of SIFs to the SMFs under the PRA and FCA. Remember that roles need to be reviewed and assessed and a straight mapping across may not be appropriate for you firm.

Current SIFs and their equivalent SMFs in the new regime

Source: FCA

Current controlled function	New PRA-designated senior management function	New FCA-designated senior management function
<i>All firms apart from credit unions</i>		
The following PRA <i>controlled functions</i> : Director function (CF1) Partner function (CF4) Director of unincorporated association function (CF5)	The following PRA-designated senior management functions: Chief Finance function (SMF2) Chief Risk function (SMF4) Head of Internal Audit (SMF5) Head of Key Business Area (SMF6) Group Entity Senior Manager (SMF7)	Executive director function (SMF3)
The PRA's non-executive director <i>controlled function</i> (CF2)	Group Entity Senior Manager (SMF7) Chairman (SMF9) Chair of the Risk Committee (SMF10) Chair of the Audit Committee (SMF11) Chair of the Remuneration Committee (SMF12) Senior independent director (SMF14)	Chair of the nominations committee function (SMF13)
The PRA's Chief executive <i>controlled function</i> (CF3)	Chief executive (SMF1)	
The PRA's Systems and Controls <i>controlled function</i> (CF28)	Chief finance function (SMF2) Chief Risk function (SMF4) Head of Internal Audit (SMF5)	
The <i>significant management function</i> (CF29)	Head of Key Business Area (SMF6) Group Entity Senior Manager (SMF7)	Other overall responsibility function (SMF18)
<i>All firms to which the function in the first column applies</i>		
<i>Compliance oversight function</i> (CF10)	None	Compliance oversight function (SMF16)
<i>CASS operational oversight function</i> (CF 10A)	None	Other overall responsibility function (SMF18)
<i>Money laundering reporting function</i> (CF11)	None	Money laundering reporting function (SMF17)
<i>Credit unions</i>		
The PRA's director <i>controlled function</i> (CF1)	Credit Union Senior Manager (SMF8)	Executive director function (SMF3)
The PRA's non-executive director <i>controlled function</i> (CF2)	Credit Union Senior Manager (SMF8)	Chair of the nominations committee function (SMF13)
The PRA's Chief executive <i>controlled function</i> (CF3)	Credit Union Senior Manager (SMF8)	None

Not just for the Banks

HM Treasury published a policy paper on 15 October 2015, confirming that the Senior Managers Regime (“SMR”) will extend to capture all FSMA authorised firms in the UK, including interdealer brokers, hedge funds and asset managers from 2018, not that very far away.

This move to SMR is intended to encourage individual accountability for decision-making in financial services firms. The first phase of the SMR will, from 7th March 2016, affect banks, building societies, credit unions and PRA designated investment firms. As usual, a consultation period will precede formal proposals for applying the SMR to other authorised firms, however, the policy paper suggests that it will apply in a broadly similar way.

Phase 1

The actual changes, published in advance in the FCA’s CP15/9, will replace the current Approved Persons Regime (APER) for banking sector firms. Key changes include:

- The SMR being narrower than the current APR, allowing regulators to focus on authorising and supervising the most senior and influential staff in banking sector firms.
- The list of prescribed responsibilities under the Senior Management Arrangements, Systems and Controls sourcebook (“SYSC”) will be expanded to include financial crime, developing and overseeing remuneration policies, and overall responsibility for compliance with the Client Assets Sourcebook.
- Each application for any senior manager approval must include a statement of responsibilities (SoR); significant changes to any SoR must be notified to the FCA.
- Firms must submit and certify an accurate “responsibilities map” illustrating management and governance arrangements.
- The introduction of a Certification Regime will shift the burden of assessing the fitness and propriety of certain staff members onto the relevant firms.
- Introduction of the Code of Conduct (COCON) Handbook under the High Level Standards section.

The FCA hopes that these rules will bolster good conduct at all levels, thereby increasing public trust in both the banking system and in the regulatory response to bad behaviour. However, firms will need to act early to prepare for the changes introduced by the new regime.

When Will the Rules Come Into Effect?

The new rules come into effect for banking sector firms on 7 March 2016, with new Senior Managers appearing on the FCA register from that date. Individuals currently approved to perform a significant influence function in a relevant firm will be eligible to transition into the new SMR role via a grandfathering notification; the final deadline for firms to submit their grandfathering notifications (including their responsibilities map and SoRs) is 8 February 2016.

Phase 2

For other FSMA authorised firms, the Treasury acknowledges there is a challenge of rolling out the SMR and Certification Regime to the other 60,000 entities; therefore, the target implementation period for the extended regime is provisionally set at 2018. The consultation period and deadlines have not yet been announced.

Key Points to Consider

The suggestions set out below are more pressing for banking sector firms in the short term, but other authorised firms would do well to start thinking about adjustments early on.

Preparation.

It would be extremely prudent for firms to begin identifying the staff roles that will require pre-approval under the SMR. Roles need to be thoroughly assessed regarding whether any areas of responsibilities require clarification and what (if any) overlap there may be. Joint responsibility does not halve the accountability. All this, and HR concerns, process changes etc need to be considered before any SoR can be prepared. In addition, firms should consider whether any changes should be made to hiring and monitoring procedures as part of the Certification Regime, which may include detailed compliance training for affected staff.

Individual Accountability

The SMR originally introduced a “presumption of responsibility” under which the relevant senior manager is guilty of misconduct where an authorised person under his management contravenes a relevant requirement. The Treasury has now acknowledged that reversing the burden of proof is disproportionate, and the measure will be removed.

This reversal of the burden of proof is possibly less of a big deal than it first appears; it is not an entirely alien concept in English law. There are similar strictures in, for example, employment discrimination legislation.

Therefore, senior managers will still face a statutory duty to take reasonable steps to prevent regulatory breaches in their areas of responsibility. The gravity of this responsibility needs to be borne in mind when considering the application of the SMR to staff, as set out below.

To Whom Will the SMR Apply?

Senior Individuals

The SMR will apply to individuals who are subject to regulatory approval and will focus on all senior individuals who hold key roles or have overall responsibility for key areas. The onus is on firms to identify the senior individuals who have overall responsibility for the activities of the firm, regardless of their job titles or in which entities they may be based within a group structure.

Non-Executive Directors

Non-executive directors (“NEDs”) in the following positions will be subject to approval and inclusion in the SMR: Chairman, Chair of the Risk Committee, Chair of the Audit Committee, Chair of the Remuneration Committee, Chair of the Nomination Committee, and Senior Independent Director. The FCA has clarified that the SMR will not apply to “standard” NEDs, i.e. those NEDs who do not chair specified subcommittees of the board.

Smaller Firms

The FCA has stated that the regime is designed to be proportionate, with less complex firms requiring fewer preapproved senior managers. However, there is no indication that de minimis exemptions will be included in the new regime; instead, proportionality is to arise as a by-product of less complex group structures and business activities.

Overseas Firms

The new regime will apply to UK branches of overseas banks and PRA-designated investment firms (incoming branches) and the near-final rules are set out in CP15/10. The PRA proposes requiring all incoming branches to have at least one individual preapproved as a Head of Overseas Branch. These individuals will typically be performing CEO-type functions.

Alongside this, the FCA proposes to apply a new senior manager function, that of Overseas Branch Senior Manager, to incoming branches. This role captures senior individuals with local responsibility for a business area, activity or management function of the branch who will typically report to the Head of Overseas Branch.

Both the PRA and the FCA acknowledge that it would be unfeasible and disproportionate to apply the list of prescribed responsibilities associated with UK firms to incoming firms. Therefore, both bodies have proposed a customised set of prescribed responsibilities for incoming branches. Neither the PRA nor the FCA intends to bring any NED functions into the scope of the SMR for incoming branches.

The new rules relating to senior management responsibilities for overseas firms will be published at SYSC 4.6 and 4.8.

Certification Regime

The Certification Regime, which will operate in tandem with the SMR, requires banking sector firms to certify the fitness and propriety of staff carrying out functions that could involve a risk of significant harm to the firm or its customers. Examples of such functions include giving investment advice, executing client orders and administering benchmarks. This fundamental shift means that decisions as to who should or should not be an approved person will no longer rest with the FCA (except for senior individuals caught by the SMR), and it will also place new hiring and monitoring responsibilities on banking sector firms.

Wider Scope

It appears from the Treasury's policy paper that the SMR will apply in a similar manner to other authorised firms: it will replace the APR entirely, and any new senior manager appointments will need to be approved by the regulator.

The Certification Regime will apply to individuals who are not carrying out senior management functions but are still capable of causing "significant harm" to the firm or its customers; this is expected to capture the remaining approved persons within a firm and possibly additional employees who are not currently approved persons. Firms will need to assess the fitness and propriety of such persons during recruitment and certify ongoing fitness and propriety at least annually.

Documentation

Firms will need to produce and submit a responsibilities map under the new SYSC 4.5. The map will specify a firm's management and governance arrangements in a single document, with the Board confirming annually that there are no gaps in the allocation of responsibilities.

Compliance – Things To Know

Firms may want to consider reviewing compliance procedures to ensure that senior managers are taking “reasonable steps” to prevent regulatory breaches in their areas of responsibility. This may need additional resource, supplied by Compliance Consultant: please email info@complianceconsultant.org with your details and we will get back to you as soon as we can. If you proceed with your own team then the FCA’s considerations when assessing such steps are clearly set out in the Decision Procedure and Penalties Manual (DEPP).

Statements of Responsibilities: providing detail on the requirement for relevant firms to submit statements confirming which areas of the business a Senior Manager is responsible (including joint responsibility areas) as part of the SMF initial grandfathering, approval process and whenever there is a significant change in those responsibilities.

Responsibilities Maps: relevant firms will be required to create and maintain an exhaustive and up-to-date ‘management responsibilities map’ which describes the firm’s management, governance and apportionment arrangements, including reporting lines and details about all relevant people and their responsibilities.

The ‘Certification Regime’: requires firms to introduce self-certification schemes to ensure all individuals in SMF and other roles that may be deemed to pose a risk of significant harm (including customer function roles) are fit and proper to carry out the role. This will bring a wider group of people than ever before under the auspices of regulatory conduct rules. The F&P checks will need to be augmented from most of the current APER checks.

Handbook Changes: A new set of ‘Conduct Rules’ replacing existing principles and applying to a wider set of individuals than under the current Statements of Principle and Code of Practice for APER. This is in the Code of Conduct Handbook: COCON.

Enforcement: Further details are provided on the regulators’ anticipated use of their new enforcement powers granted under the Act, including a new criminal offence in relation to Senior Managers taking a decision which causes a relevant firm to fail, which is punishable by up to seven years in prison and/or an unlimited fine.

Also, don’t forget that there is also a new **Whistleblowing policy - PS15/24** - Impact of new Whistleblowing policy requirements to be considered in the new regime.

Breach Reporting

The SMR will require that any conduct rule breaches by senior managers are reported within seven days. Actual or suspected breaches by employees who fall outside of a Senior Manager Function but are still subject to Conduct Rules, must be reported on an aggregate annual basis. This does not, however, override the new Senior manager conduct rule SC4: "You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice."

Regulatory references

The consultation is scheduled for publication in Autumn 2015, and it will particularly consider recommendations from the Fair and Effective Markets Review (FEMR). Final Handbook text is to be in place in time for commencement of the regimes in March 2016.

In Conclusion

Challenges & Considerations

There are four main areas Compliance Consultant believe will be most impacted by the new regimes:

Governance

The regimes ultimately require robust and well evidenced governance frameworks including clear articulation of legal entity level committee structures and their respective roles and responsibilities.

Policies and Procedures

The new regimes will cover a significantly wider population with the addition of the certified and conduct layers, and firms will need to design robust frameworks, especially for the certified regime. Self-supervision of a significant population in the certified regime is new and a considerable challenge.

People and Culture

One of the key aims of the new regime is to transform the culture and raise standards in banking. As a result, the SMCR necessitates changes to capabilities, culture and HR processes to underpin behavioural change.

Data, Systems and Technology

The increased focus on evidentiary requirements means the regimes will require quality management information to underpin responsibilities. There is also an opportunity to automate and streamline many of the requirements of the regime using technology solutions.

Other Areas for Consideration

Reasonable steps

SMFs will be required to show that they have taken reasonable steps to prevent a breach in their area. This will involve documenting near misses as well as actual risk events.

Control environment

Multiple individual breaches in a short period in one area of a business are likely to raise eyebrows and board investigations regarding the state of the control environment. A thorough independent review may provide weak areas.

SMF oversight

A breach by an individual under the Certification Regime may raise questions as to how effectively the relevant SMF is overseeing them. Full documentation will be needed for regular/crisis meetings and complete appraisal of the situation leading to it.

A supportive culture

Consider how best to embed the conduct rules without creating a blame or cover up culture. Instead, try to drive an open, supportive, and well-informed environment where the actual facts are collated and reviewed, not hearsay or finger-pointing. Executives falling on their sword, or "doing the decent thing" may have once been acceptable, but serves no purpose in today's risk learning and understanding environment.

Staff training

Your staff need to be well trained on recognising breaches and potential breaches, and feel comfortable in reporting all issues and near-misses. In this way, the root causes of these breaches can be analysed, put right, and learnt from rather than papered over, hidden and relegated to assumption making. This will not only help mitigate the risk of creating a blame or cover-up culture, but make everyone more transparent, bringing bad processes to light so they can be dealt with.

To help you make sure you are on-track, assuming you have already gone down the track a while, your To-Do list from the end of 2015 might look like this.

- Undertake any required consultation with SMF's and Notified NED's in respect of contractual changes
- Issue finalised contract addendum letters to all SMF's and Notified NEDS's and obtain agreement to changes where required
- Create enhanced Job Description Template for SMF roles
- Establish the annual FIT requirements and the specific associated actions including a defined layered approach depending on seniority
- Governance Map
- Establish the ongoing requirements re Handover Procedures for SMF's or Certified Employees leaving and the specific associated actions
- Establish the on boarding requirements for new SMF's, Notified NEDs or Certified Employees joining and the associated actions (including requirements re references and criminal checks)
- Design the process for ensuring that all Breach Reporting requirements are adhered to
- Communicate requirements to identified employee to ensure full understanding of consequences of being certified
- Obtain specific confirmation of required activities regarding Certification Regime
- Make all required changes to template contracts for future employees
- Establish the annual FIT requirements and the specific associated actions including a defined layered approach depending on seniority
- Arrange to deliver appropriate training for SMF's, Notified NEDS and Certified Staff
- Decision regarding excluded segment - involve/awareness training?
- Training on the conduct rules and specific awareness for relevant rules for their work. e.g. CR 5 "Market Conduct" in wholesale markets.
- Establish the training requirements (content, dates and venues) re the SMF's, notified NED's and Certified Employees re Conduct Rules
- Establish the training requirements for Other Staff re Conduct Rules
- Establish the specific requirements for responding to reference requests for SMF's, Notified NEDs or Certified Employees leaving
- Upload (or enter) SOR's re online submission requirements (deadline is 8th Feb)
- Upload Management Responsibilities map (and Form K) re online submission requirements (deadline is 8th Feb)
- Obtain confirmation of required changes to standard contract templates (Generic, Exec and Notified NED) order to cover all contractual SMR requirements for future new recruits
- Ensure that Directors and Officers (D&O) Insurance is expanded to an adequate level and that policy detail accurately reflects SMR
- Online Form K submission re grandfathering the SMF's and informing re the notified NEDS (deadline is 8th Feb)
- Outsourcing (or in-sourcing) of Key activities - Appropriate arrangements in place.
- Policy For Certificated Employees
- Breaches Policy - Rules For Conduct Breaches Reporting (SUP 15 Annex 7R- Form H) (see SM&CR : extension to all FSMA Authorised Persons October 15) removes reporting requirement but Conduct Rules still state appropriate disclosure (ref SC4).
- Conduct Breaches Register - Addendum to regulatory breach register?

- New Whistleblowing policy - PS15/24 - Impact of new Whistleblowing policy requirements
- Update Employment Handbook re requirement for all staff to adhere to ongoing conduct requirements
- Create Conduct Risk Reporting Medium/BSC?
- Prepare certificates for all employees falling under Certification Regime
- Contracts/Offered - Contracts offered conditional on ongoing F&P
- Annual Assessment - Ongoing F&P for SMF and Certified Employees
- Certification system - Performance reviews may need to include "breaches" and "additional regulatory training" undertaken, increases in scope of responsibility.
- Responsibilities Map - Process/Owner to keep updated?
- Handover Policy - transfer of all information and material required to take up the role.
- Policy must consider (*at least*);
 - Emergency take up - death/incapacity of current SMF
 - Period of handover
 - Required acceptance of handover completion
 - Interactions with other SMFs to provide rounded view
 - Implement the Breach Reporting process
 - Failures - How dealt with and by who (see policy)

Ongoing

- Issue certificates to those employees falling under Certification Regime
- Identification of employees through to 7th March 2017 (initial certification deadline)
- New Joiners - in certification - who monitors? Frequency? Oversight?
- Changing roles - in or out of certification - who monitors? Frequency? Oversight?
- MRT job moves - in or out of certification - who monitors? Frequency? Oversight?
- MRT tag on all job roles
- Deliver appropriate training for other staff on Conduct Rules
- Issue Certificates for Certified Employees to be issued by 7th March 2017

If you need to review your arrangements and test their functionality, contact us on 0207 097 1434 or email info@complianceconsultancy.org for a compliance consultancy with qualified, experienced, practical and competent staff.