

## Senior Managers and Certification Regime update 2019

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In March 2016, the Senior Managers and Certification Regime, commonly referred to as the SMCR, came into force for banks, building societies and other deposit takers, and in December 2018 for insurers. The SMCR is the new regulatory regime for individuals, replacing the Approved Persons Regime, with the aim of enhancing and embedding a culture of individual responsibility and accountability within firms.

In this webcast, I will examine some of the lessons learned as the implementation of the SMCR has bedded down for banks, building societies and other deposit takers and some of the key things that solo-regulated firms should be doing as they near transition into the SMCR. The webinar is split broadly into 3 topics covering:

- the FCA's Stocktake Report;
- the FCA's final amendments to the SMCR rules; and
- noteworthy rules that apply to solo-regulated firms.

### FCA's Stocktake Report

Turning to the first of these topics, in July 2019, the FCA published what it called its Stocktake Report.

The review, based on interviews with individuals in firms who have worked with the SMCR, covered a wide range of themes, including:

- senior manager accountability;
- certification; and
- conduct rules.

I will summarise some of those key findings now.

#### Senior manager accountability

The concept of reasonable steps is part of the Duty of Responsibility introduced in the legislation that established the SMCR. The FCA has set out guidance in the Decision Procedure and Penalties manual that includes some of the factors that the FCA would expect senior managers to have regard to in considering whether they have taken reasonable steps to avoid a contravention from occurring or continuing. However, unsurprisingly perhaps, the FCA says it is not able to provide an exhaustive list that would cover every situation. The importance of creating the 'right' culture is a recurring theme of the FCA's.

### Certification regime

As far as the Certification Regime is concerned, whilst firms have broadened their approach to assessment of staff beyond solely technical skills and managers are in a better position to assess the behaviours of their certified staff, the FCA found that most firms could not demonstrate the effectiveness of their assessment approach; use of subjective judgement; or how they ensure consistency across the population.

For instance, it was not clear from the FCA's review that firms are using the Certification Regime to evaluate if managers of certification staff (who are themselves certified) are competent managers.

### Conduct rules

The most significant of the FCA's findings concerns the way in which firms have implemented the conduct rules.

The FCA's evidence suggests that firms have not always sufficiently tailored their conduct rules training to staff's job roles. Firms are often using their own values to articulate how they bring the conduct rules to life.

The conduct rules are a critical foundation for firms' culture and the conduct of individuals. The FCA says that it is essential that staff understand the rules and how they apply to them. Under the Financial Services and Markets Act 2000, firms must:

- notify all relevant persons of the conduct rules that apply in relation to them; and
- take all reasonable steps to secure that those persons understand how those rules apply in relation to them.

### Embedding

The FCA observed a difference in the levels of firms' SMCR maturity. That difference is driven by several factors. This includes size, resources, firms' cultural baseline and their interactions with regulators. Generally, the larger banks, with more resources and exposure to the regulators, are more mature in their approach.

Some firms seem to have been less successful in embedding the regime below the senior manager level.

When asked by the regulator what arrangements firms have in place to ensure the effective implementation of the SMCR it will not be enough for firms to say what they are doing or have done.

In view of its findings, the FCA has said that it will increase its supervisory focus on the conduct rules. It expects all SMCR firms to ensure that they are embedding the conduct rules in their businesses to meet their obligations under the regime. It is clear that solo-regulated firms should have this in mind when they implement the SMCR.

### **Final amendments to the SMCR (for all firms)**

Moving on the second of the topics of this webinar, in Policy Statement 19/20 the FCA published its final rules confirming amendments made to the SMCR, together with near final rules for solo-regulated firms. There are key points for firms to note, and not just solo-regulated firms, arising from those rules. I will summarise the more important of those now.

### Head of Legal

The FCA explains that including the Head of Legal in the Certification Regime and applying the Conduct Rules will deliver most of the benefits of including these individuals in the SMCR without compromising the law of privilege.

Whilst the FCA says that will be sufficient to drive up standards of conduct and ensure fitness and propriety of legal staff, practitioners and those holding in-house legal roles have repeatedly criticised the proposal. Regardless of how the SMCR applies to a Head of Legal, it misses the point that such staff are separately regulated, including from a conduct perspective, by the Solicitors Regulation Authority.

The FCA provides some additional guidance.

- It is not proposing to exclude lawyers from performing a senior manager function, for example the Chief Operations Officer or Head of Compliance.
- In these instances, the Head of Legal will still have responsibility as a Senior Manager for their additional role. Firms will be expected to clearly outline the responsibilities for each role in the individual's Statement of Responsibilities.
- The FCA does not see its proposal to exclude the Head of Legal from the requirement to be approved as a Senior Manager as creating an opportunity for firms or Senior Managers responsible for other business areas or functions to avoid their responsibilities.

Under the Certification Regime, firms must identify as Certified Staff anyone who supervises or manages a Certified Function who is otherwise out of scope of the SMCR.

The justification for this is to ensure that there are clear lines of responsibility and accountability. The FCA does not envisage legal roles other than the Head of Legal will fall within the senior manager function contained within the Certification Regime.

In terms of the procedure for the transfer of the Head of Legal to the Certification Regime, firms will not be required to undertake regulatory referencing or redo fit and proper assessments for these individuals as long as their job does not change.

### Client Dealing Function

The amended rule has been drafted in a way that provides firms with the flexibility to exercise judgement on whether a role requires Certification. The relevant factors in making such a judgement include whether the role is simple or largely automated; and involves exercising discretion or judgement.

The FCA explained that it was not possible to provide an exhaustive definition of all the ways that an individual could be considered to be undertaking client dealing activities; that will depend on the firm's business and the way responsibilities have been allocated across its staff.

### **Application of SMCR to solo-regulated firms**

Finally, I will look at the headline points arising from Policy Statement 19/20 as the FCA's final rules apply specifically to solo-regulated firms. The FCA draws attention to two of those rules in particular.

### Application of the Certification Regime to systems and controls roles

The first is the application of the Certification Regime to a firm's systems and controls.

This change only affects Core and Limited Scope firms (including branches) under the regime for solo-regulated firms, where such individuals are not required to be approved as Senior Manager Functions for the Systems and Controls roles.

As with a firm's Head of Legal, anyone who supervises or manages someone holding a Senior Management Certification Function will also have to be a member of Certified Staff and be identified as such.

### Extension of SC4 to executive directors

The other of the final rules that is particularly noteworthy concerns the application of the conduct rules to firms' executive directors.

The rationale for that change is that it is more often a firm's executive directors who are involved in the day-to-day running of a firm's business. Senior Manager Conduct Rule 4 states that "[y]ou must disclose appropriately any information of which the FCA or PRA would reasonably expect notice."

The FCA justifies this change as proportionate because Senior Manager Conduct Rule 4 would already apply to all non-executive directors of UK Limited Scope firms.

### **Conclusion**

The changes to the SMCR and associated guidance provide welcome further clarity for firms, particularly concerning the role of Head of Legal and the Client Dealing Function.