Thursday, 12 July 2018

SMCR: extension to all FCA firms – near-final rules and further consultation on new public register

SUMMARY

- The FCA has confirmed that for solo-regulated firms, the SMCR will apply from **9 December 2019**
- Grandfathering arrangements will apply to existing approved persons, subject to prior notification by firms in certain cases
- Transitional arrangements will apply to fitness and propriety assessments, certification of certified staff and staff training on the new conduct rules, all of which must be completed for the first time by **9 December 2020**
- The near-final rules are broadly the same as contained in the FCA's original consultations, although certain amendments and clarifications have been made in some areas
- The FCA is also consulting on introducing a new public register ("**the Directory**") which will contain information about a range of individuals within firms subject to the SMCR, including those who will no longer require FCA approval to perform their roles (e.g. certified staff)
- The proposals for the new Directory would require firms to report additional information to the FCA on a regular basis
- The consultation on the Directory is open until **5 October 2018**

On 4 July 2018, the FCA published the following package of documents relating to the extension of the Senior Managers and Certification Regime (**SMCR**) to insurers and all FCA firms:

- PS 18/14 on Extending the SMCR to FCA Firms, containing feedback on the FCA's original proposals in CP 17/25 and CP 17/40, and including near-final rules (some of which build on those set out in PS 18/15);
- PS 18/15 on Extending the SMCR to Insurers, which addresses the extension of the SMCR to insurers and includes near-final rules which will come into force on **10 December 2018** (subject to certain transitional arrangements or earlier entry into force of technical provisions). We do not discuss the provisions that are specific to insurers in any further detail in this briefing;
- PS 18/16 on Final Guidance: the Duty of Responsibility for Insurers and FCA Solo-Regulated Firms, containing feedback on the FCA's original proposals in CP 17/42; and

- CP 18/19 on Introducing the Directory, containing proposals for a new public register for senior managers, certified staff and certain other individuals. This consultation will close on **5 October 2018**.

We summarised the FCA's original proposals for the extension of the SMCR in our earlier client briefings published in July 2017 and December 2017.

In this client briefing we provide a brief overview of the final positions reached by the FCA and highlight any material changes from the original suggested rules. **The final proposals have not changed significantly from the original consultations**.

SUMMARY OF KEY POINTS

- ***Commencement date:*** HM Treasury has now confirmed that the SMCR will be extended to solo-regulated firms on **9 December 2019**, although this remains subject to the necessary secondary legislation being enacted. This means that firms will have approximately 17 months to prepare for implementation. Until that date, firms will need to continue to comply with the existing approved persons regime (**APR**).

- ***Grandfathering of existing approved persons:*** The FCA has confirmed that it will be using the transitional arrangements that it had originally proposed. In practice, this means that current holders of controlled functions under the APR within Core Firms and Limited Scope Firms will automatically convert to senior management functions (**SMFs**) in accordance with a correlation table published by the FCA. The exception is in relation to non-executive chairs, where the firm will need to notify the FCA that the relevant individual needs to be approved for the SMF chair function by submitting a Form K. Approvals granted in relation to controlled functions under the APR that no longer exist under the SMCR will lapse. Enhanced Firms will need to submit a new Form K to specify how their existing controlled functions should be converted into SMFs.

- ***Transitional arrangements:*** Firms will have 12 months from the commencement of the SMCR (i.e. until **9 December 2020**) to complete their fitness and propriety assessments, certification of certified staff and staff training on the new conduct rules.

- ***General approach:*** The FCA is largely proceeding on the basis of the proposals that it originally put forward in the initial consultation papers, although there have been some relatively minor amendments and clarifications in places.

- ***Firm classification criteria:*** Firms will still need to classify themselves as either Limited Scope Firms, Core Firms or Enhanced Firms, but the criteria for classification as an Enhanced Firm have been modified slightly, essentially to bring in a 3-year average calculation for the purposes of certain thresholds. This is designed to reduce the risk of firms exceeding a relevant threshold due to a temporary spike in the relevant metric.

- ***Senior management functions:*** For Core Firms, the FCA is retaining the SMFs that it originally proposed. This means that to the extent that a Core Firm has them, the chief executive, directors, partners, chair, money laundering reporting officer and compliance officer will need approval from the FCA as a senior manager (**SMF manager**). Notably, this means that the current CF30 (customer) function will lapse, although individuals who perform that role are likely to be classified as certified staff (see below). Additional SMFs will apply to Enhanced Firms, as originally proposed by the FCA, while Limited Scope Firms will be subject to a lighter regime. Each SMF manager will be required to have a statement of responsibility.

- ***Prescribed responsibilities:*** The FCA has retained five of the six original proposed prescribed responsibilities for Core Firms, which must each be allocated to an SMF manager. After feedback, it has withdrawn the proposed prescribed responsibility relating to informing the governing body of its legal and regulatory obligations. However, it has also added a new prescribed responsibility on which it had consulted separately following the Asset Management Market Study, which will only be relevant to managers of authorised funds. This relates to responsibility for the manager's value for money assessments, independent director representation and acting in investors' best interests. Additional prescribed responsibilities will apply to Enhanced Firms, whereas Limited Scope Firms are not required to allocate any prescribed responsibilities.

- ***Certification regime:*** The FCA is applying the certification regime as originally consulted upon, including as regards the territorial scope of the relevant rules. This means that individuals performing services for the firm from outside the UK may be subject to the certification regime if they are classified as material risk takers or are dealing with UK clients. Firms will have 12 months from the commencement date of the extended SMCR to ensure that all relevant staff have been certified as fit and proper.

- ***Fitness and propriety assessments:*** The FCA has confirmed that SMF managers, other directors who are not SMF managers and certified staff must be assessed as fit and proper on an annual basis. Criminal records checks will only be required where the firm is applying for a person to perform an SMF and will not be required again as part of the annual fitness and propriety assessment.

- ***Regulatory references:*** As the FCA originally proposed, firms will be required to obtain regulatory references from a person's employers for the previous 6 years where that person is being appointed as an SMF manager, a non-SMF director of the firm or a member of certified staff. The FCA has confirmed that where an individual moves to perform another function within the firm's group that requires regulatory references, the new group entity appointing that individual may be able to rely on references previously received if they are drafted in such a way that it is clear that the person providing the reference would permit such reliance.

- ***Conduct rules:*** The FCA has adopted the Conduct Rules (**COCON**) as originally proposed, meaning that SMF managers will be subject to the full set of rules and other relevant staff will be subject to a more limited set of requirements. These rules will apply to all staff within the firm in relation to its regulated activities and a range of other connected activities or activities that may have an impact on the firm, except where the relevant staff are only performing a role on an exhaustive list of ancillary activities. Firms will be required to notify the FCA where they have taken action against an individual for breach of the COCON rules.

- ***Additional requirements for Enhanced Firms:*** As originally proposed, Enhanced Firms will be subject to additional requirements relating to the preparation of a firm-wide responsibility map and the use of handover procedures to provide for a smooth transition between incoming and outgoing SMF managers.

- ***Application to UK branches:*** Incoming UK branches of EEA and non-EEA firms will be subject to a limited application of the SMCR. For EEA firms, this will include a limited set of SMF manager requirements, as well as compliance with the certification requirements and conduct rules for individuals based in the UK. For non-EEA firms, this will include a somewhat wider set of SMF manager requirements, a limited range of prescribed responsibilities and compliance with the certification requirements and conduct rules for UK-based individuals.

- ***Proposed new "Directory":*** In CP 18/19, the FCA has put forward new proposals to introduce a public "Directory"; a single interface that would include details of all SMF managers who appear in the Financial Services Register, together with certified staff and non-SMF directors. As the FCA will not have the necessary details for certified staff or non-SMF directors, firms will be required to supply additional information through the FCA's Connect system to compile the Directory. In addition, they will be under an ongoing obligation to keep the relevant information up-to-date.

- ***Appointed representatives:*** The FCA has confirmed that the SMCR will not apply to individuals or approved persons working within appointed representatives (**ARs**). This is because the relevant legislation does not currently provide the FCA with any power to extend the SMCR in this way. The current APR will therefore continue to apply to ARs after the extension of the SMCR to other firms. The only exception is in relation to limited permission consumer credit firms that also act as ARs in relation to other business (for example, where such firms are ARs in relation to insurance business) – since such firms are FCA authorised firms, they will be subject to the SMCR when it is extended, even though they are also ARs.

We will be preparing a fuller guide for clients, setting out a summary of the final rules and proposals. If you would like to receive this, please liaise with your usual Travers Smith contact.

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