



Thursday, 22 December 2016

Senior Managers and Certification Regime: extension to all FCA-authorized firms

As 2017 beckons, all non-bank (and non-insurer) FCA authorised firms will need to begin focusing on the new Senior Managers and Certification Regime (**SMCR**) which will be introduced at some point in 2018. This will replace the current approved persons regime for these firms. Banks have been subject to the SMCR since March 2016. In this briefing, we set out a basic outline of what we consider are likely to be the key elements of the bank SMCR that will be carried forward and applied to all firms.

At the present time, there is very limited information about how this regime may need to be recalibrated for the 50,000 or more non-bank firms of varying size and nature to which the regime will be extended. As a result, our observations below assume that the new non-bank regime will be substantially modelled on the existing banking regime, but with suitable modifications to reflect proportionality principles. These observations are subject to any contrary future proposals being published by the FCA.

We have included an overview diagram in the [appendix](#) to this briefing, setting out the application of different requirements under the SMCR.

THE HEADLINE POINTS

- SMCR will replace current approved persons regime for all non-bank and non-insurer FCA-authorized firms from 2018
- Precise application date in 2018 has not yet been announced
- Existing banking SMCR may form basic template, but with proportionality modifications
- Formal consultations will begin in 2017 (expected to be in H1)
- Senior managers will need FCA pre-approval
- Each senior manager will need a personal responsibility statement setting out his/her areas of responsibility
- Firms will need a responsibility map to show how all relevant responsibilities have been allocated to senior managers
- Other employees who perform functions considered by regulators to pose a significant risk of harm to the firm or customers will need to be certified annually by the firm as fit and proper
- All employees within the firm, except those performing only ancillary roles, will be subject to new conduct rules and will need to be trained on them

PART A: INTRODUCTION TO THE SMCR

WHAT IS THE SMCR?

The SMCR was originally introduced under the Financial Services (Banking Reform) Act 2013 and has applied to banks since 7 March 2016. It is designed to replace the existing FCA approved persons regime (**APR**), which the UK government considered had become discredited following high profile governance failures at certain major financial institutions.

A similar regime (the Senior Insurance Managers Regime) has also applied to insurers and reinsurers since 7 March 2016.

The Fair and Effective Markets Review into the UK fixed income, currency and commodities markets proposed extending the SMCR to UK regulated firms in those markets. In October 2015, the government announced its intention to apply the regime to all FCA-regulated firms and subsequently empowered the FCA to do this under the Bank of England and Financial Services Act 2016.

WHEN WILL THE SMCR BE EXTENDED TO NON-BANK FIRMS?

Currently, the FCA has indicated that the new SMCR for non-bank firms will apply from 2018. However, it has not yet given further details about the specific application date in 2018. Firms should monitor consultations and any other developments next year for any further announcements on this.

WHO WILL BE WITHIN SCOPE OF THE NEW NON-BANK SMCR?

If the non-bank SMCR is implemented in the same way as the regime for banks, it will affect all staff within an FCA-authorized firm, except those who carry out only administrative or other ancillary roles specified by the FCA (which include receptionists, print room staff, cleaners and security guards). The regime applies different requirements to:

- persons performing senior management functions;
- persons performing significant harm functions, but not performing senior management functions; and
- all other employees within the firm, except those who perform certain administrative or ancillary roles specified by the FCA.

PART B: THE SENIOR MANAGERS REGIME

WHICH FUNCTIONS WILL BE DESIGNATED AS SENIOR MANAGEMENT FUNCTIONS?

For the banking regime, the functions designated as senior management functions (**SMFs**) include, but are not limited to, a wide range of roles such as:

- the Chief Executive function;
- the Executive Director function;
- the Chief Risk function;
- the Head of Key Business Area function;
- the Compliance Officer function; and
- the Money Laundering Reporting Officer function.

There is also a residual "sweep-up" SMF termed the "Other Overall Responsibility" function whereby a person has overall responsibility for one or more activities, business areas or management functions within the firm, but is not otherwise allocated one of the other SMFs. A number of non-executive roles (such as Chairman) are also designated SMFs. An individual performing a designated function must be approved as an SMF. Firms must ensure that certain prescribed responsibilities (see below) are allocated to SMFs.

It seems likely that many individuals who are currently approved to perform FCA governing functions (such as the CF1 (Director) or the CF4 (Partner) functions) or certain other FCA required functions (such as the CF10 (Compliance Oversight) or CF 11 (Money Laundering Reporting) functions) under the existing APR will need to be approved as SMFs under the new regime. It is also likely that some firms will need to register individuals for SMFs who are not currently approved persons. However, a proportionate application of the applicable rules may result in firms having fewer individuals performing SMFs than currently perform significant influence functions.

WHAT ARE THE REQUIREMENTS THAT WILL APPLY IN RELATION TO A PERSON PERFORMING AN SMF?

Requirement for prior FCA approval

Firms will need to obtain prior FCA approval for each person who is appointed to perform one or more SMFs (an **SMF manager**) before that person begins to perform the relevant function. This is essentially the same as the current requirement under the APR for firms to obtain advance FCA approval for individuals performing controlled functions within a firm.

In addition, under the bank SMCR, before they submit an application for approval in relation to an SMF manager, banks are required to satisfy themselves that the relevant candidate is a fit and proper person to perform the function through a vetting procedure. This includes a requirement to obtain the fullest information that the firm can lawfully request in relation to criminal record checks.

It is likely that similar requirements will apply when the SMCR is extended to non-banks. It is expected that for existing approved persons under the APR, grandfathering rules will apply.

Statement of responsibilities

When applying for approval for an SMF manager, the firm will need to include in its application, amongst other requirements, a "statement of responsibilities" setting out which aspects of the firm's affairs that person will be responsible for managing. Where a person holds multiple SMFs, there must be one responsibility statement including all of that individual's responsibilities. The purpose of the statement is to ensure clearer individual accountability amongst SMF managers for specific parts of the firm's business.

While not required to be sent with the application, the firm will need to maintain a "management responsibilities map" setting out details of reporting lines and lines of responsibility in relation to its governance arrangements, including how SMFs have been allocated.

Duty of responsibility

The government has said that the new statutory "duty of responsibility" will be extended to SMFs under the non-bank SMCR. The duty states that:

- where a firm has committed a breach of one or more regulatory requirements; and
- an SMF manager was responsible for the management of the firm's activities in relation to which that breach occurred,

the FCA may take enforcement action against the SMF manager if (s)he did not take such steps as a person in the SMF manager's position could reasonably be expected to have taken to avoid the breach occurring. The burden will be on the FCA to show that the SMF manager failed to take such steps. While there has been some

speculation about whether this is more onerous than the existing requirements under the APR, it is generally thought that in practice this will not impose a higher legal standard of responsibility on senior managers than under the APR.

The existing criminal offence under the Financial Services (Banking Reform) Act 2013 relating to senior managers who recklessly cause or allow a financial institution to fail will **not** apply to non-bank firms.

Allocation of prescribed responsibilities

Under the bank SMCR, firms are required to allocate a number of specified "prescribed responsibilities" to one or more SMF managers, although certain responsibilities only need to be allocated if they are relevant to the firm's activities or circumstances. There is a long list of prescribed responsibilities in the context of banks, including, for example, responsibility for:

- the firm's compliance with regulatory requirements relating to the management responsibilities map;
- anti-financial crime policies and procedures;
- ongoing training and professional development of the firm's governing body;
- development and implementation of the firm's remuneration policy; and
- the firm's compliance with the FCA's client assets and client money rules.

Generally, the FCA does not expect that prescribed responsibilities should be split between two SMF managers or allocated to two SMF managers jointly. However, in appropriate cases a prescribed responsibility may be divided or shared if this is appropriate and can be justified. In the context of the banking regime, the FCA has suggested that this may be the case where there is a job share, or where incoming and departing SMF managers work together as part of a temporary handover programme. Some non-bank firms are likely to struggle with this principle and may call on the regulator to be flexible on this point.

Given the wide range of FCA firms, it is possible that the list of prescribed responsibilities may be simplified under the non-bank regime. Alternatively, the FCA may include a general list of prescribed responsibilities which only need to be allocated in so far as they are applicable to the relevant firm.

Regulatory references

The current bank SMCR will, from 7 March 2017, require firms that are appointing a person to perform an SMF to take reasonable steps to obtain appropriate references from the person's current employer and all previous employers for the past six years. There will be a corresponding duty on FCA-authorized firms to provide a reference to the relevant bank in such circumstances.

In light of the recent focus by the government and regulators on preventing "rolling bad apples", it seems likely that this requirement will be included in the non-bank regime, although possibly applied in a more proportionate manner.

PART C: THE CERTIFICATION REGIME

WHAT IS A SIGNIFICANT HARM FUNCTION?

Under the bank SMCR, the FCA has specified a list of significant harm functions (**SHFs**), which include, amongst others:

- CASS oversight;
- acting as a proprietary trader;

- being a material risk taker under the banking remuneration rules;
- being responsible for approving the deployment or amendment of a trading algorithm or having significant responsibility for monitoring a trading algorithm; or
- undertaking a client dealing function.

In addition, any employee (other than an SMF manager) who manages, either directly or indirectly, another person performing an SHF will also be deemed to perform an SHF. This aims to ensure that any intermediate managers between SMFs at the top of the firm and those individual employees performing SHFs will also be caught by the requirements of the SHF regime.

For the extension of the SMCR to non-banks, the list of SHFs may need some adaptation.

WHAT ARE THE REQUIREMENTS IN RELATION TO A PERSON PERFORMING AN SHF?

Annual "fit and proper" certification

From 7 March 2017, banks will be required to take reasonable care to ensure that none of their employees perform an SHF in relation to any regulated activity that the firm carries on unless the firm has issued a valid certificate to the employee to perform the relevant SHF. There are exemptions for certain emergency appointments (for example, to cover unforeseen absences) or for certain overseas functions based only temporarily in the UK.

A firm is only permitted to issue a certificate to an employee in connection with the performance of an SHF if the firm is satisfied that the person is a fit and proper person to perform that function. This will involve an assessment of the person's honesty, integrity and reputation, as well as whether the person has the necessary qualifications, training, competence and personal characteristics to perform the role. Where necessary, one certificate may be issued to cover multiple SHFs performed by the same person.

Certificates will only be valid for a maximum of 12 months, meaning that the firm will need to undertake (at least) an annual certification exercise in relation to each person performing an SHF.

If the firm concludes that it cannot issue a certificate to an employee in relation to an SHF, the employee will be unable to fulfil that function. In such circumstances, the firm will need to consider whether the basis for the refusal is such that it needs to be notified to the FCA (for example, due to the employee having breached applicable FCA rules).

Regulatory references

As with SMF managers above, firms that are issuing a certificate in respect of an employee performing an SHF (including annual renewal of a certificate) will need to obtain regulatory references in relation to the person's current employment and employment for the previous six years.

OTHER STAFF WHO MAY BE WITHIN THE SCOPE OF THE EXTENDED SMCR REGIME

Under the existing bank SMCR, employees who do not perform SMFs or SHFs will still be within scope of certain conduct rules (see below) from 7 March 2017, unless they perform only certain specific administrative or ancillary roles. The list of ancillary roles for these purposes includes, amongst others:

- receptionists and switchboard operators;
- post room staff;
- security guards;

- medical staff;
- cleaners; and
- catering staff.

The aim of these exclusions is effectively to carve-out any role which would be the same if it were performed in a non-financial services firm.

All employees of the firm who do not perform SMFs or SHFs but whose roles are not excluded by the exhaustive list will be within scope of the SMCR conduct rules. This is likely to be the case under the extended regime for non-banks.

PART D: OTHER ASPECTS OF THE SMCR

CONDUCT RULES AND THEIR APPLICATION

For the purposes of the bank SMCR, the conduct rules are contained within the Code of Conduct (COCON) sourcebook in the FCA Handbook. COCON applies to all of the following:

- SMF managers;
- employees who have been certified to perform an SHF (and employees who would need to be certified to do so, but for available exemptions for temporary or emergency appointments); and
- any other employee, except a person who only performs one or more of the specified ancillary roles that fall outside of the SMCR.

However, certain rules under COCON apply to all staff, whereas others apply only to SMF managers. The COCON requirements are broad, high-level principles which are similar in content to the current FCA Statements of Principle for Approved Persons. COCON also sets out guidance on how the FCA will assess compliance with the relevant conduct rules.

Firms that are subject to the current SMCR are required to notify all persons who are subject to COCON of the rules that apply to them and to take all reasonable steps to ensure that such persons understand those rules. Such steps specifically include the provision of suitable training, although it is possible that this could be provided in a standardised and proportionate manner.

One of the defects that the government identified with the existing APR was that it is often difficult to take enforcement action against individuals who are not approved persons, as they are not subject to the existing Statements of Principle. The effect of COCON is to provide the FCA with the ability to pursue a much wider range of staff within a firm for failure to comply with similar core principles set out in the COCON rules.

The scope and application of the conduct rules within non-bank firms is likely to be similar.

WHAT IS THE TERRITORIAL SCOPE OF THE SMCR REQUIREMENTS?

The SMF requirements have no territorial limitation, so in relation to a UK bank, an SMF manager based anywhere in the world will need to comply with the applicable rules. For non-UK banks, the SMF requirements only apply in connection with branches maintained in the UK (with modified rules for EEA banks), but overseas managers responsible for such branches may need to be approved as SMF managers.

In relation to employees performing SHFs, the certification regime only applies where the relevant employee either performs the function from a UK establishment or, when performing the function from an overseas establishment, has contact with a UK client.

TRIVERS SMITH

The conduct rules in COCON apply to SMF managers, and certified employees performing SHFs who are "material risk takers" under remuneration rules, wherever their conduct takes place. In relation to all other staff subject to COCON, the rules apply where the conduct is performed from a UK establishment or otherwise involves contact with a UK client from an overseas establishment.

WHAT SHOULD NON-BANK FIRMS BE DOING TO PREPARE FOR THE SMCR?

The FCA has not yet published concrete proposals on the precise form of the non-bank SMCR, but is expected to begin formal consultations next year. In the meantime, firms should continue to monitor for further announcements and may wish to engage with industry associations to set out views on how the SMCR can be applied proportionately to different sectors.

Firms should also consider their current governance structures and how responsibilities are currently allocated within the firm. They may wish to begin considering how this might map to the existing bank SMCR framework, although they should keep in mind that the final non-bank SMCR may be applied in a more proportionate way or possibly may have a significantly different structure.

In light of the large number of other regulatory developments which are placing demands on management time, firms should also start planning for the appropriate working groups, project plans and budgets that may be necessary to ensure proper implementation of the SMCR when the final application date in 2018 becomes clearer.

FOR FURTHER INFORMATION, PLEASE CONTACT

10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7295 3000
F: +44 (0)20 7295 3500
www.traverssmith.com



Jane Tuckley

Partner

E: jane.tuckley@traverssmith.com
T: +44 (0)20 7295 3238



Tim Lewis

Partner

E: tim.lewis@traverssmith.com
T: +44 (0)20 7295 3321



Phil Bartram

Partner

E: phil.bartram@traverssmith.com
T: +44 (0)20 7295 3437



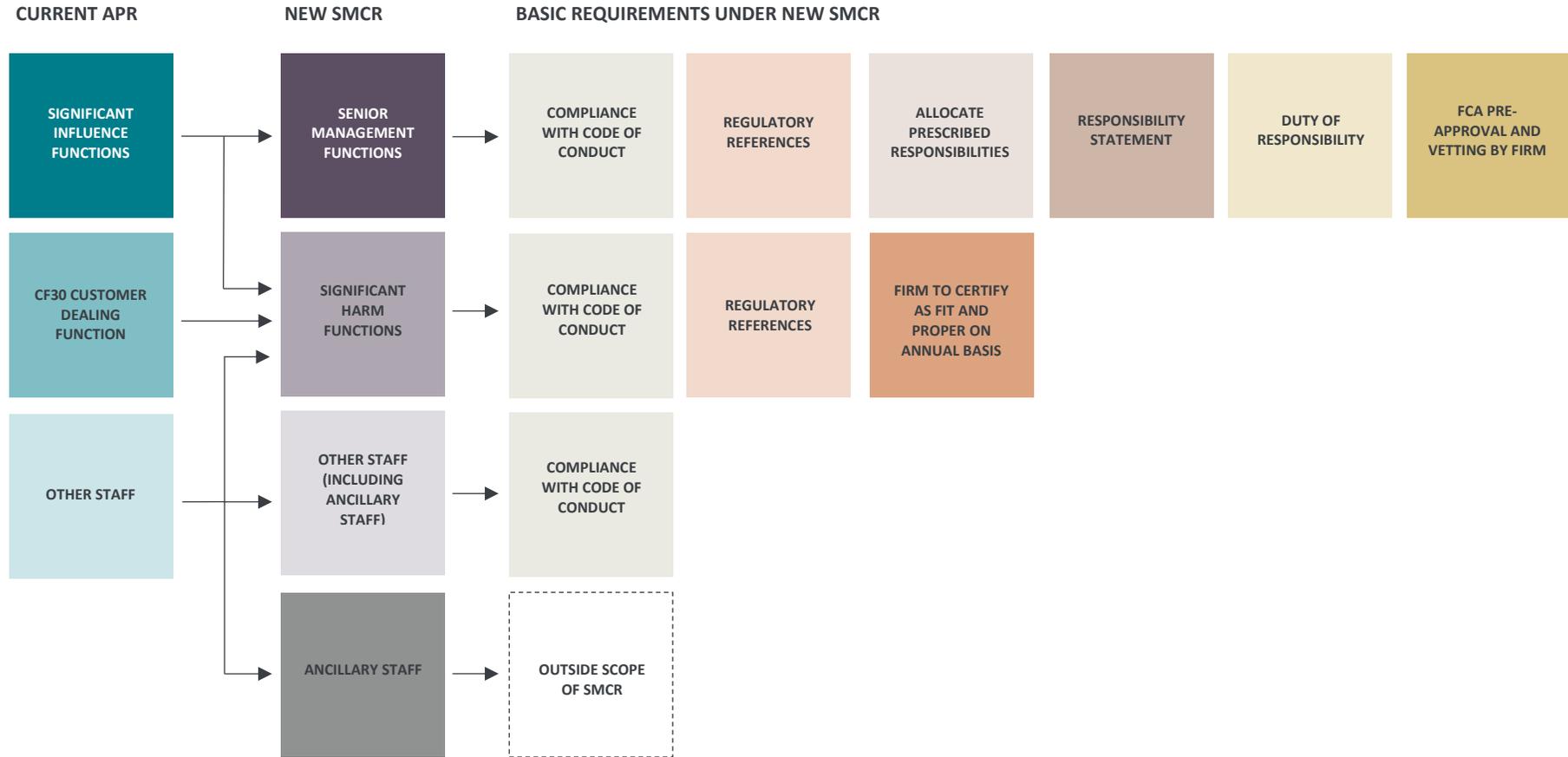
Stephanie Biggs

Partner

E: stephanie.biggs@traverssmith.com
T: +44 (0)20 7295 3433

Appendix

POTENTIAL REQUIREMENTS UNDER NON-BANK SMCR



NOTE: The above diagram indicates the approximate correspondence between existing controlled functions under the current APR and potential new categories of staff under the SMCR. The actual mapping will depend upon the FCA's final proposals on extending the SMCR to non-bank firms. The requirements indicated are the key requirements under the SMCR, but staff within a firm may be subject to a range of other legal and regulatory requirements.