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4 Key Points About The Expanded Senior Managers Regime

By **Mark Taylor**

Law360, London (August 8, 2017, 10:52 PM BST) -- Britain's finance watchdog is taking its show on the road in September, traversing the U.K. to inform tens of thousands of firms what to expect when they are included in onerous new conduct rules for the first time next year.

U.K. authorities had created the Senior Managers and Certification Regime after the 2008 financial crisis to hold top executives at the biggest banks and largest investment firms to dedicated and specific conduct requirements. But the government always intended to eventually widen the net to include individuals at nonbank financial institutions such as insurers and credit unions.

The Financial Conduct Authority and Prudential Regulation Authority launched separate consultations last month detailing their proposals to widen the SMCR for all firms regulated under the Financial Services and Markets Act. Both consultations end in November, and final rules are expected to be published in 2018.

"The impact of the extension of the rules is significant, as it dramatically increases the amount of firms which will now be required to comply with the regime," Michael Thomas, financial services partner at Hogan Lovells, told Law360.

Here, Law360 examines what insurers, fund managers, credit unions, payment providers and banks of all shapes and sizes need to know about the expanded code as the FCA ushers in a new age of tougher scrutiny of staff and procedures.

Large or Small, There is No Escape

When the new rules are implemented, U.K. authorities' dragnet under the SMCR will increase from approximately 935 regulated firms to more than 60,000.

While the FCA says it is not appropriate to apply the toughest parts of the regime to a small high street firm as it would to a multinational bank, it has surprised many in the sector with just how much it has carried over from the banking regime to other financial services firms.

"The biggest impact will be the extension of the FCA's conduct rules to almost every person who works in financial services," said Guy Wilkes, financial regulation partner at Mayer Brown International LLP. "Many employees of smaller firms will be surprised that they are now in the regulator's sights."

Even just a handful of staff in a tiny office providing financial advice to a small group will be subject to the regime, according to Thomas.

“Implementation of the new requirements is likely to be both costly and time-consuming,” he said. “And smaller firms will potentially be the hardest hit by their new compliance obligations.”

One aspect of the SMCR that may catch firms out is the need to submit a statement of responsibilities to the FCA when applying for a senior manager to be approved. They must keep this up to date and re-submit it whenever there is a change to responsibilities.

The biggest names in banking will be familiar with this level of scrutiny, said Jake Green, financial services partner at Ashurst LLP, but other firms may not.

“The shift from the regulator to the firm in how senior managers and certified individuals are assessed as fit and proper is only the tip of the iceberg,” Green said. “There is lots more work to do.”

Wilkes points out that the FCA has generally found it easier to ascribe the failings of smaller firms to its directors and managers, as smaller firms tend not to have complex matrix management structures like banks. The result, he said, is that banks may feel less of an impact from the new rules even as they scramble to comply with the heightened scrutiny.

“Nevertheless, like it did with banks, [the SMCR] is likely to raise awareness of conduct issues and concentrate the minds of those managers who in the past may have ignored their responsibilities,” Wilkes said.

It is Proportionate — to an Extent

The FCA has floated a three-tiered approach to compliance with all aspects of the SMCR depending on the size, scale and complexity of a firm: enhanced, core and limited scope.

The largest 1 percent of firms will be subject to the enhanced SMCR. These are firms with assets under management of £50 billion ($64.95 billion), with a total intermediary regulated business revenue of £35 million or more per annum, and non-bank mortgage lenders with 10,000 or more regulated mortgages outstanding.

The enhanced category carries extra responsibilities, and the new rules are very much akin to the existing regime for banks and building societies, said Andrew Henderson, financial services partner at Eversheds Sutherland LLP.

“These firms will require responsibilities maps, handover procedures and will need to make sure there is a senior manager responsible for every area of their firm, including operations, HR,” he said.

About 14,000 firms will be subject to the core regime, which includes the Senior Managers Regime, the Certification Regime and Conduct Rules.

For these firms, roles including chair, chief executive, executive director, partner, compliance oversight and money laundering reporting officers fall into the bracket.

They must be approved by the FCA and subject to background checks, and they have a “duty of responsibility” that makes them liable for a problem that occurs under their watch. The FCA will measure the steps taken to gauge whether they acted properly.

Under the Certification Regime, staff who are not senior managers but whose roles mean they can be deemed material risk-takers or have “significant harm” on customers, the markets or the firm itself, are included.

“These staff will be certified by the firm who will need to deem the individual fit and proper on an annual basis,” Henderson said.

Conduct Rules will apply to almost everyone who works in financial services, Henderson added. They include “integrity,” “being open with the regulator,” and “treating customers fairly.”

There are further conduct rules, covering areas such as delegation and effective control.

The limited scope category covers firms and individuals where financial services activity is secondary to the main activity, such as retail firms or motor dealers, and totals about 33,000 names. These firms will need to designate a single senior manager to be held accountable.

A breach of the SMCR will result in prosecution by the FCA, with harsher penalties including potential criminal liability reserved for serious offenses and nonreporting or trying to cover up misconduct.

Outsourcing Compliance Isn’t a Way Out

The FCA has concerns about a growing trend in financial services to outsource certain senior functions, lawyers say, as some firms use this as a way of ducking responsibility.

But in its consultation, the agency notes that firms are “fully responsible for all of its obligations” under SMCR even if they use a third party for operational functions.

Under the conduct rules, firms will be required to explain clearly how responsibility for outsourced functions is allocated among its senior managers. Banks and insurers will have to continue complying with outsourcing requirements, meaning while a function such as IT may be outsourced, the responsibilities cannot be.

Green said, for example, that for a firm outsourcing its internal audit function, an executive director must take responsibility for ensuring every person involved in the performance of the service is independent from the persons who perform external audit.

The Clock is Ticking

With the current summer slowdown in effect, the FCA has opened the consultation period to November. But with so many other regulatory changes coming down the line, firms need to give the SMCR their immediate attention, experts say.

“We are aware that many firms are already setting up project teams and steering committees and commencing their communication strategies,” Henderson said.

New data protection laws, the massive Markets in Financial Instruments Directive that will rewrite the bloc’s securities rules, payment sector reforms and anti-money laundering laws are all competing demands that enter force between now and January.

“It will be important for firms to keep momentum given competing demands on resource due to other regulatory changes,” Henderson said. “We know the regulators are very keen to get feedback and market intelligence as they further shape the regime.”

--Editing by Rebecca Flanagan and Emily Kokoll.

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