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Legal Update
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New Rules Released: Senior Managers and Certification Regime Extended to All Firms

The Financial Conduct Authority (**"FCA"**) and Prudential Regulation Authority (**"PRA"**) published their consultation papers[1] on 26 July 2017 containing proposals for extending the Senior Managers and Certification Regime (the **"SMCR"**) to almost all regulated firms (the **"Extended SMCR"**).[2] The proposals are intended to ensure that firms have in place effective corporate governance procedures, responsibilities for certain activities are allocated within firms and individuals are held accountable for their actions, improving culture within firms and strengthening market integrity.

The FCA currently regulates persons in the financial services sector through the Approved Persons Regime (**"APER"**). After the financial crisis, the government recommended that the regulators develop a new system to hold individuals accountable for their actions and so the SMCR was devised, applying to banks, building societies, credit unions and PRA-designated investment firms from March 2016. The equivalent regime for insurers was implemented (also in March 2017) through the Senior Insurance Managers Regime (**"SIMR"**) which will be amended to incorporate the Extended SMCR. The Extended SMCR seeks to ensure that all financial services firms are held accountable in a similar but proportionate way.

Does the Extended SMCR impact my firm?

The Extended SMCR will be relevant to almost all financial services firms. The SMCR is already in place for banks and these consultations extend the regime to 47,000 firms authorised under the Financial Services and Market Act 2000 (**"FSMA"**).[3] The Extended SMCR consultations affect:

- all FSMA authorised firms regulated by the FCA and most employees that work for these firms, including all existing authorised persons;
- overseas branches of non-UK firms that have permission to carry out FCA regulated activities in the UK, as well as the employees of these branches;
- Solvency II insurers, incoming branches of non-UK firms and Insurance Special Purpose Vehicles (**"ISPVs"**) and staff at these firms;
- all insurers outside the scope of Solvency II or Non-Directive Firms (**"NDFs"**) and staff within these firms. Large NDFs are where the value of assets for all the regulated activities carried out exceed £25 million.

The changes will mean that the SMCR will replace the current APER in almost all firms.

The Extended SMCR does not affect approved persons of appointed representatives of firms. The FCA intends to approach these in a follow up consultation.

1 The FCA proposals are contained in CP 17/25, "Individual Accountability: Extending the Senior Managers and Certification Regime to all FCA firms" and the PRA proposals are contained in CP 17/26 " Individual Accountability: Extending the Senior Managers and Certification Regime to insurers".

2 These changes will be introduced by amendments to FSMA through the Bank of England and Financial Services Act 2016.

3 For further information the SMR and SIMR, please see Mayer Brown's coverage .

Do the same rules apply to everyone?

Firms will welcome the regulators' decision not to adopt the same approach that they did for banks and insurers for the Extended SMCR. To reflect the diverse nature of the firms supervised by the FCA and PRA, the requirements of each regulator will also differ.

FCA approach

The FCA has divided the rules into three regimes, each with different obligations to be applied proportionately. These regimes are:

- *Core regime*: this will apply to all solo-regulated firms, i.e. those only regulated by the FCA, except for limited scope firms. The core regime consists of the SMR, the Certification Regime and the Conduct Rules.
- *Enhanced regime*: these are extra requirements and will only apply to a small number of solo-regulated firms whose size, complexity and potential impact on consumers demand more attention.
- *Limited scope regime*: firms that currently have a limited application of APER (for example limited permission consumer credit firms and sole traders) will only need to adhere to a reduced set of requirements, e.g. there are fewer Senior Management Functions (**"SMF"**) with the focus being on money laundering and compliance. Six extra responsibilities (the **"Prescribed Responsibilities"**) will not apply to limited scope firms.

PRA approach

The PRA has decided to apply the full SMCR to Solvency II firms and large NDFs (which will also be subject to certain elements of the Enhanced Regime). A streamlined regime will apply to Small NDFs, Small Run-off firms and ISPVs. All insurers will be subject to the Certification Regime, fit and proper tests and Conduct Rules requirements.

Senior Managers Regime

For all firms, the SMR will impose requirements on the most senior people, those who perform the SMFs.

The SMFs for FCA firms are: Chair, Chief Executive, Executive Director, Partner, Compliance Oversight and Money Laundering Reporting Officer (**"MLRO"**).

For Solvency II and Large NDFs the SMFs are Executive Director, Partner, Other Overall Responsibility, Compliance Oversight, MLRO, Chair of Nominations Committee, Chair of the With-Profits Committee and Conduct Risk Oversight Officer (Lloyds).

For Small NDFs and Small Run-off firms, the SMFs will be Executive Director, Partner, Compliance Oversight and MLRO. Different SMFs will apply to EEA and non-EEA branches and ISPVS.

Regulatory approval

Individuals will need to gain regulatory approval before starting Senior Manager roles to ensure that they are suitable for the key jobs they will be performing, although there will be grandfathering of existing Significant Influence Function holders from the current regime.

Statement of Responsibilities

All Senior Managers will need a Statement of Responsibilities which identifies the activities for which they are responsible and accountable. Firms will be responsible for providing this to the FCA when a Senior Manager applies to be approved or there is a major change in their responsibilities.

This Statement of Responsibilities will therefore need to be kept up to date. The FCA has said it will consult later this year on the template of a Statement of Responsibilities and the process for submitting these.

Duty of responsibility

All Senior Managers will have a Duty of Responsibility which means that if the firm contravenes a regulatory requirement in the area for which they are responsible, the Senior Manager could be held accountable. In order to be held accountable, the PRA/FCA will need to show that the individual did not take 'reasonable steps' to avoid this breach. To do this, the PRA/FCA will make reference to the Statement of Responsibilities. The guidance to be applied to this duty is likely to mirror that in place for banks and insurers[4] but the FCA will consult on this later this year.

Prescribed Responsibilities

The FCA is proposing six extra responsibilities or Prescribed Responsibilities that must be allocated to Senior Managers and an additional responsibility for Authorised Fund Managers (**"AFM"**). The Prescribed Responsibilities are:

- Performance by the firm of its obligations under the SMR, including implementation and oversight.
- Performance by the firm of its obligations under the Certification Regime.
- Performance by the firm of its obligations in respect of notifications and training of the Conduct Rules.
- Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime.
- Responsibility for the firm's compliance with CASS (if applicable).
- Responsibility for ensuring the governing body is informed of its legal and regulatory obligations.
- Responsibility for an AFM's value for money assessments, independent director representation and acting in investors' best interests.

The Prescribed Responsibilities will ensure that a Senior Manager is held responsible for any conduct and prudential risks. For insurers, the FCA will introduce additional Prescribed Responsibilities to those currently put in place by the FCA. Insurers will be subject to a range of FCA, PRA and shared (PRA/FCA) Prescribed Responsibilities.

Each Prescribed Responsibility should be given to the Senior Manager most responsible for the particular issue and the Senior Manager will need to ensure they have the knowledge and experience to carry out that responsibility. Firms will only be able to divide or share the responsibility in limited circumstances, e.g. where there is a job share. There are fewer Prescribed Responsibilities for small NDFs, third country branches and ISPVs. Prescribed Responsibilities will not apply to EEA Branches.

The FCA and PRA are also proposing that criminal records checks be run against those seeking to be Senior Managers and firms will need to request regulatory references for Senior Managers as well as NEDs who are not Senior Managers and Certified Persons.

Certification Regime

The Certification Regime will apply to employees of financial services firms who are not Senior Managers, but whose role means it is possible for them to cause significant harm to the firm or its customers e.g. processing payments or insurance claims. This is the biggest single change for insurers who currently do not have a Certification Regime under the SIMR. Certification Regime employees will not need to be FCA/PRA approved but firms must certify that they are 'fit and proper' on an annual basis. What determines if an individual is fit and proper will vary depending on the role.

The FCA and PRA Handbooks will set out the roles that fall under the Certification Regime. These are individuals carrying out a significant management function, CASS oversight function, client dealing function, proprietary traders, algorithmic traders, material risk takers, functions subject to qualification requirements and anyone who supervises or manages the aforementioned persons. Not all of these will apply to all firms.

4 DEPP 6.2.9-E in the FCA Handbook.

Conduct Rules

The FCA is proposing that Conduct Rules, as contained in the "COCON" part of the FCA Handbook, will apply to almost every person working in financial services and insurance firms and are designed to improve behaviour of every person working in financial services, imposing requirements for them to act with integrity and be open and cooperative with regulators. COCON will replace the current APER section of the FCA Handbook. Senior Managers will be subject to additional Conduct Rules. For insurers, Conduct Rules currently apply but this application is limited to approved persons.

The current proposals for the application of the Conduct Rules will be narrower than the rules currently in place for banks in that the rules will apply to a firm's regulated and unregulated financial services activities, e.g. an activity carried on in connection with regulated activities rather than all activities as in the case of banks.

Firms will be required to train staff so they know how the Conduct Rules apply to them. Firms must also notify the FCA if they take disciplinary action against a person for breaching a Conduct Rule.

As under the SMR and SIMR, the Conduct Rules under the Extended SMR will apply to all financial services employees of financial services firms unless they carry out ancillary activities, e.g. post room staff and receptionists.

The SMR has no territorial limit and will apply to anyone performing a SMF whether based in or outside the UK. The Certification Regime will only apply to Certification Functions based in the UK or to individuals based outside the UK who are dealing with UK clients, unless it involves material risk takers who will be subject to the Certification Regime wherever they are located.

Enhanced FCA/PRA regime

Extra requirements will be placed on large and complex firms (around 1% or 350 firms of the firms regulated by the FCA). Firms coming under the new regime include IFPRU firms, CASS Large firms and those with Assets Under Management of £50 billion or more.[5] For insurers, certain enhanced requirements will apply, as specified below.

The enhanced SMCR will require firms to apply all of the requirements under the core regime, as well as provisions that mirror the current regime for banks:

- *Additional SMFs*: additional SMFs will need to be approved by the FCA, such as the Chief Operations Function and Head of Internal Audit. This is not a feature of the PRA regime.
- *Additional Prescribed Responsibilities*: enhanced firms will need to give more Prescribed Responsibilities to their Senior Managers, e.g. compliance with the rules relating to the Responsibilities Map and safeguarding and overseeing the independence of the performance of the internal audit function.
- *Overall Responsibility*: enhanced FCA firms will need to make sure that there is a Senior Manager with overall responsibility for every area, business activity and management function of the firm. The Senior Manager with overall responsibility for a particular area will be responsible for briefing and reporting to the governing body about their area of responsibility and where necessary putting matters for decision about their area of responsibility to the governing body. For insurers, only Solvency II, large NDFs and non-EEA branches will have to comply with this requirement.

5 Other firms affected under the enhanced regime include: firms with total intermediary regulated business revenue of £35 million or more per annum, firms with annual regulated revenue generated by consumer credit lending of £100 million or more per annum and mortgage lenders (that are not banks) with 10,000 or more regulated mortgages outstanding.

- *Responsibilities Maps:* enhanced FCA firms will need to have a single document that sets out the firm's management and governance arrangements including reporting lines and how responsibilities are allocated. This will also apply to Solvency II firms and large NDFs as well as non-EEA and EEA Branches. For Solvency II firms and large NDFs this will replace the governance map currently in place. Firms must keep the maps on their record for 10 years.
- *Handover Procedures:* enhanced FCA firms will need to make sure that a person who is becoming a Senior Manager has all the information and material that they could reasonably expect in order to do their job effectively and the firm must have a policy in place to set out how it complies with this requirement and maintain relevant records. This requirement will also apply to Solvency II firms and Large NDFs.

What does my firm need to do?

The FCA has stressed that a firm that does not have an individual performing a particular SMF does not need to create one if the SMF does not apply to the firm. Firms will however need to assess their current governance structure and activities and identify which regime applies to them. Larger firms will undoubtedly need more assistance implementing the new regime than smaller, less complex firms. The experience of banks in implementing the SMR is that existing structures may be ill-suited to applying a regime requiring one named individual to take responsibility for an area and that some restructuring is necessary.

Firms will face a number of questions from individuals affected by the new regimes and so it is important that they get up to speed quickly so these can be addressed at any early stage. HR and employment teams will also need to be engaged from the outset, particularly where breach of the rules could lead to disciplinary action and where regulatory references will need to be provided.

The FCA and PRA have requested all replies to the consultation by 3 November 2017. A summary of responses and final Policy Statement is expected in summer 2018 with the implementation date likely to be no earlier than the end of 2018.

If you have any questions or comments in relation to the above, please contact the authors or your usual Mayer Brown contact.

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