

# Extending the senior managers and certification regime

Assuring not just the rules, but the underlying principles



# Strengthening accountability



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In 2017 the FCA published details on the extension of the Senior Managers and Certification Regime (SM&CR). The extension builds on the existing framework, which has been a requirement for banks, building societies and credit unions since March 2016. The SM&CR will now apply to all FCA regulated firms, who will be categorised as Limited, Core or Enhanced scope for a proportionate implementation.

The SM&CR extension will be implemented through a phased introduction. Insurers are now subject to the regime and solo regulated firms must comply by 9 December 2019.

The framework aims to improve individual accountability within a firm, protecting the consumer and the integrity of the financial services sector. It extends culpability across every level of the business, and staff must be able to demonstrate that they have taken reasonable steps to comply with their regulatory responsibilities.

Drawing on lessons learned from the initial Senior Managers Regime, firms should recognise that implementation is not easy. It is a slow process, which requires significant time and resources. So it is important not to underestimate the effort required to apply the new regime.

The FCA released a further consultation paper in December 2017, proposing an automatic conversion process for Limited and Core scope firms to simplify the transition from the Approved Persons Regime. Despite this, when firms convert to the SM&CR they may require significant organisational and infrastructural changes for successful, long term implementation.

# What is changing?

The SM&CR aims to improve accountability within a firm, protecting the consumer and the integrity of the financial services sector. As such, it consists of four pillars, which promote a culture of individual accountability across the organisation. These four pillars apply to all firms but, depending on the size and type of organisation, there will be a proportionate application of the regime. At the same time the FCA is introducing a directory which will capture all senior management and certified personnel.

The diagram below outlines these four pillars, and how they are applied across the SM&CR population.

## Pillar 1

### Senior Managers Regime

- The Senior Managers Regime aims to improve accountability of Senior Management

## Pillar 2

### Certification Regime

- The Certification Regime aims to improve accountability for those who are not Senior Managers, but could cause significant harm to a firm or its customers
- Individuals do not need to be approved by the FCA but firms must certify they are Fit and Proper; a certificate to this effect must be issued on an annual basis

## Other

- All other non-ancillary staff, including contractors, are subject to the Conduct Rules

## Ancillary staff



## Pillar 3

### Conduct Rules

- Conduct Rules apply to all employees, not just those falling under the Senior Managers or Certification Regimes
- It excludes ancillary staff such as caterers, reprographics or post room staff
- These are new enforceable rules, which outline expectations for personal conduct
- The rules replace the Statements of Principle and Code of Practice for Approved Persons in the FCA Handbook

## Pillar 4

### Fitness and Propriety

- Fitness and Propriety requirements apply to both the Senior Managers and the Certification Regime and must be renewed regularly
- These requirements include adequate training, qualifications, reference and criminal records checks, amongst others

# Limited, core and enhanced scope firms

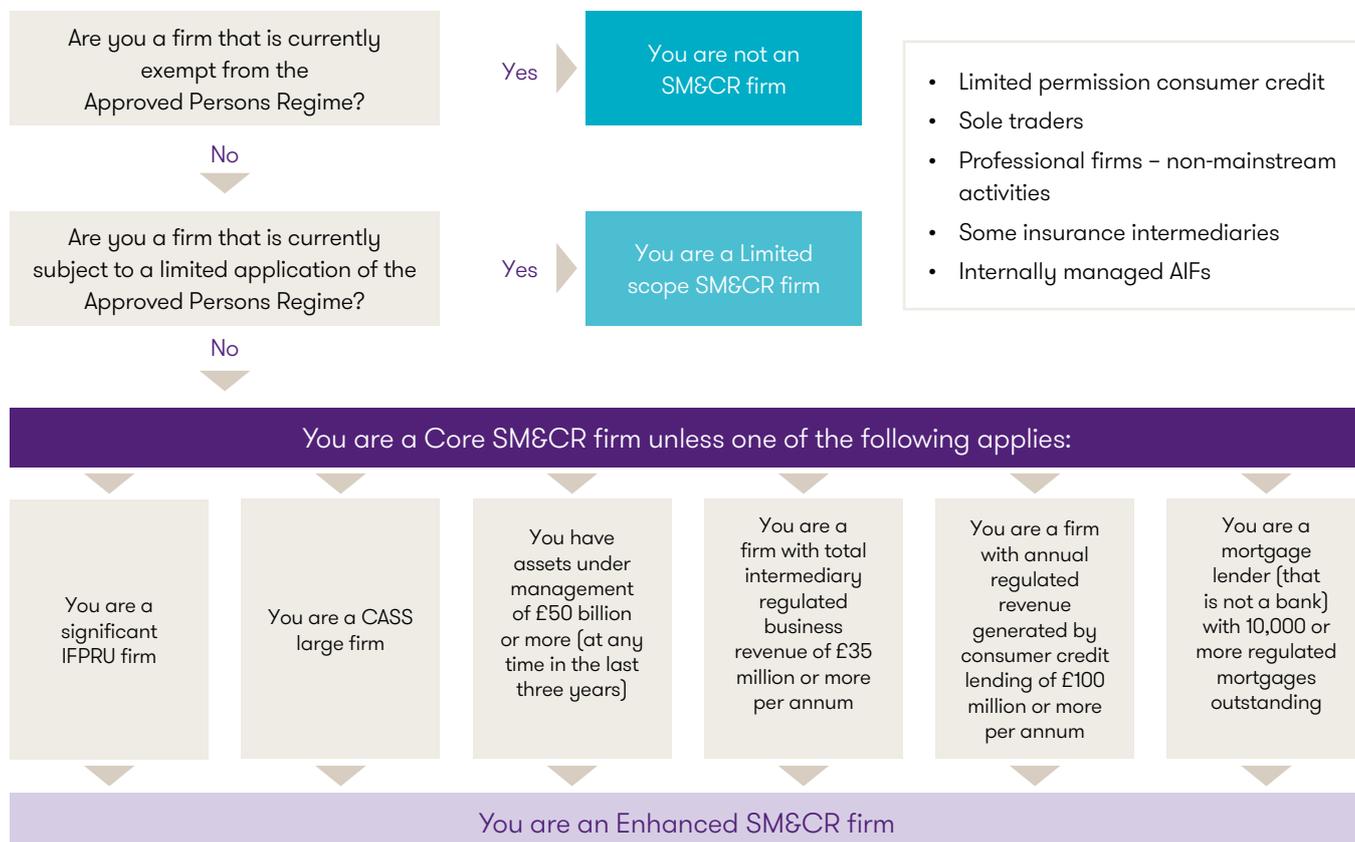
Given the scope and range of FCA regulated firms, a ‘one size fits all’ approach would not be appropriate in applying the SM&CR extension. There are three firm classifications, which are determined by the size and nature of the organisation.

For a proportionate approach, firms will be classified across three categories, resulting in the following market metrics:

		Number of firms
<b>Limited scope firm</b>	This applies to smaller firms with limited licenced activities	32,800
<b>Core firm</b>	The majority of solo regulated firms will fall under this category	14,280
<b>Enhanced firm</b>	This includes more complex businesses	350

## Identifying which scope applies

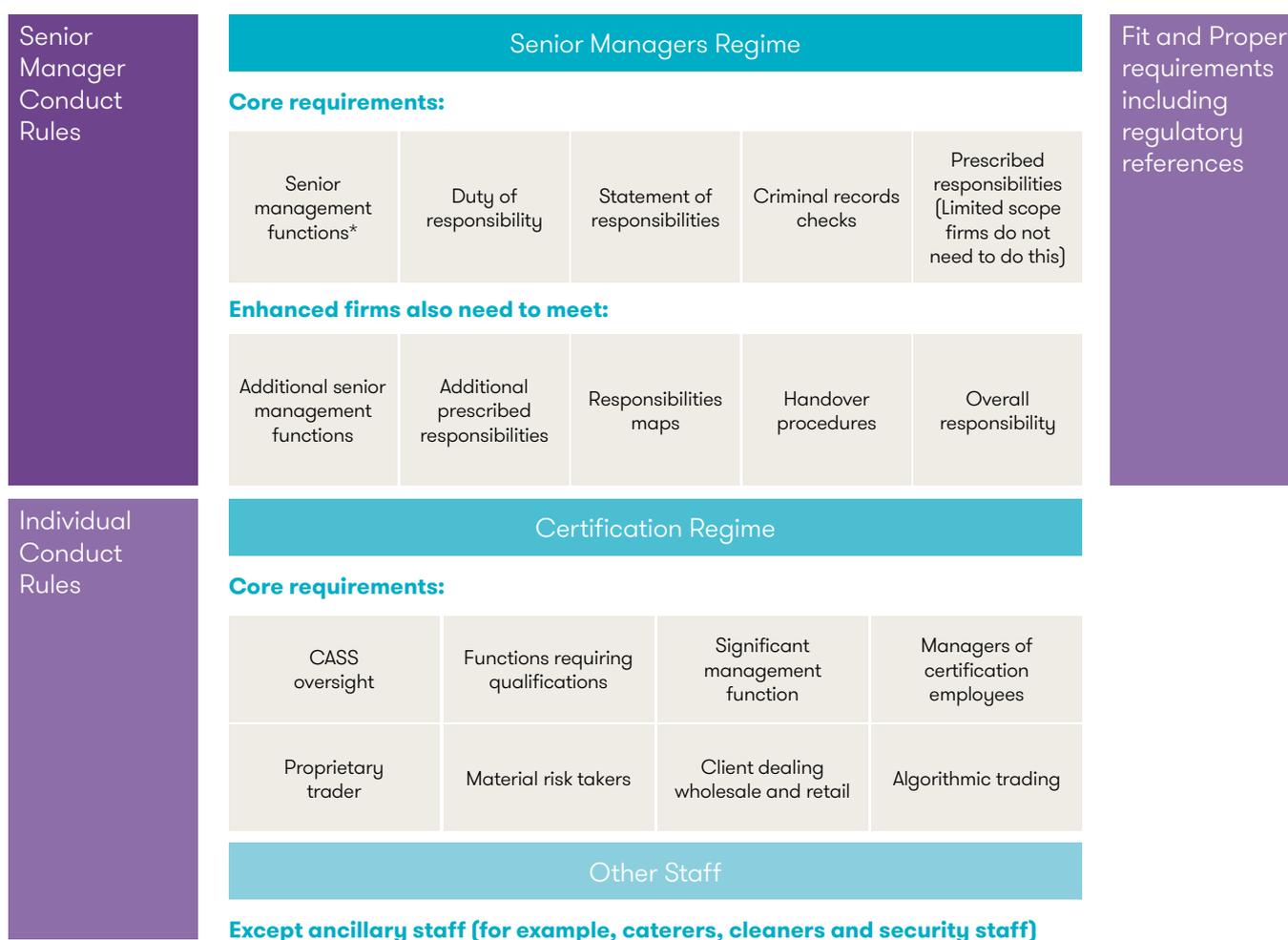
As a starting point, firms must identify which classification applies to them. The diagram below outlines the defining criteria:



Source: The Financial Conduct Authority

# Overview of the SM&CR toolkit

Once a firm has identified which classification is applicable, they must determine which elements of the Senior Managers Regime apply. The diagram below offers a guide to applicable elements for each classification.



\*The FCA will convert these automatically for Limited and Core scope firms

Source: The Financial Conduct Authority



The above summary of requirements come with a significant amount of infrastructure/ documentation necessary to support the regime and the captured individuals

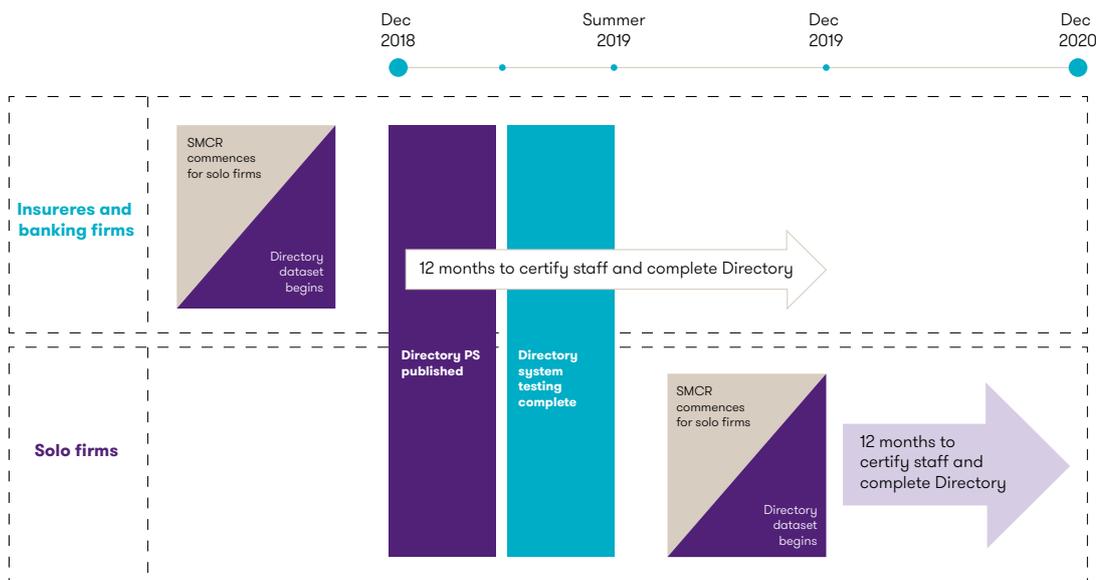


The activity each firm must undertake in this area cannot be underestimated

# The directory

The FCA have proposed a Directory, which lists all SM&CR staff and provides details on their previous roles, qualifications and workplace locations, amongst others. It will be publicly available, aiming to increase consumer trust and reduce the potential for fraud.

The Directory will serve as a single point of reference and draw on information from both the FS Register and the Connect database. While the FS Register only holds details of FCA approved staff, the Directory will include details of both SMFs and those holding firm appointed Certification Functions.



For firms subject to automatic conversion, the FCA will add details to the register on their behalf. However, it is up to the firm to check the details are correct and listed in the Directory.

All firms have an initial 12 month period in which to certify staff and submit their details to the Directory. For insurance firms, and those who have already implemented the first wave of the SM&CR, this means December 2019. All other solo regulated firms have until December 2020 to submit their information to the Directory.

# The four pillars

Senior Managers Regime

Certification Regime

Conduct Rules

Fitness and Propriety



# Senior managers regime

## Pillar 1

The Senior Managers Regime requires firms to clearly allocate responsibilities and keep a comprehensive record of individual accountability at a senior level. It does this through pre-defined Senior Management Functions (SMF) and every individual holding an SMF role must be approved by the FCA.

### What is a Senior Manager?

- In the context of the SM&CR, a Senior Manager is a person in the upper tiers of management, who performs a function which is specified by the FCA.
- The FCA has produced a list of Senior Management Functions (SMFs) that each firm should consider when implementing the regime.
- Not all firms will need to implement each of these functions, but where they do apply, the post holder must be approved by the FCA and meet all regulatory requirements on an ongoing basis.
- There are a core number of SMFs which will apply to most firms, with less for Limited scope and more for Enhanced firms, reflecting the scale and complexity of their business.

Enhanced firms face additional requirements including responsibility maps, overall responsibilities and handover procedures.



In order to promote a culture of individual accountability, the roles and responsibilities of each Senior Manager must be clearly defined. To achieve this, the FCA requires all SMF holders to have their duties recorded in a Statement of Responsibility.

Under the proposed conversion process, the FCA will automatically convert Approved Persons to the corresponding SMFs where possible. See page 10 for further details on the conversion process.

Many firms may need to undertake a degree of restructuring for effective SMF allocation, with specific attention to the following:

- drawing a number of responsibilities into a single SMF where appropriate
- assessing the seniority and authority of proposed SMFs
- the potential for overburdening key staff through allocation of multiple SMF roles.

### **Statement of Responsibilities (SoR)**

Every SMF position must have an SoR. This is an essential requirement and responsibilities between SMFs must not overlap. It is important to pay close attention to ensure the SoR is factual and accurate - however, this also means that responsibilities cannot be diluted or delegated.

During the conversion process, a firm must create and retain SoRs for every Approved Person becoming an SMF holder. For subsequent SMF roles, an SoR must be submitted outlining to the FCA which obligations will fall under their remit.

### **Duty of Responsibility**

Every SMF holder has a Duty of Responsibility to adequately carry out their obligations against their SoR. In the event of a regulatory or conduct breach, the relevant SMF holder must demonstrate that reasonable steps were taken to prevent it.

### **Prescribed responsibilities**

While not all SMF roles must be allocated, the FCA have defined a number of prescribed responsibilities which must be assigned to a Senior Manager (Limited scope firms are exempt). These are designed to embed accountability for key regulatory responsibilities.

Prescribed responsibilities should always be allocated to the person with the highest seniority for that area within the firm, to ensure they hold final oversight. Where prescribed responsibilities are allocated to a Senior Manager, it must be reflected in their SoR.

While some senior management roles may be outsourced, the regulatory responsibility for prescribed responsibilities still remains with the Senior Manager to oversee that outsourced activity.

# Certification regime

## Pillar 2

The Certification Regime focuses on those individuals other than senior managers, who could cause serious harm to the firm. It aims to ensure they have the necessary competencies, experience and qualifications to meet their responsibilities.

The Certification Regime aims to embed individual accountability for those who are not SMFs, but who hold significant responsibility. As per SMFs, the FCA has produced a list of Certification Functions, not all of which must be allocated within a firm. Certification Functions may include:

CASS oversight	Significant management function	Proprietary trader	Client dealing wholesale and retail	Systems and control function
Functions requiring qualifications	Managers of certification employees	Material risk takers	Algorithmic trading	Customer function

While the Senior Managers Regime requires individuals to be approved by the FCA, the Certification Regime calls for individuals to be certified by the organisation itself. Certification is essentially ensuring that an individual has adequate experience and qualifications for their position on an annual basis. An individual may hold multiple Certification Functions, but where this is the case the firm must check the individual is Fit and Proper for each role.

The firm must re-approve individuals on an annual basis and issue a certificate that provides the individual with the ability to perform the role for another 12 months.



# Conduct rules and fitness and propriety

Individual accountability is further embedded across the firm through Conduct Rules and Fitness and Propriety requirements. While Fitness and Propriety assessments are specific to individuals falling under the Senior Managers and Certification Regimes, Conduct Rules apply to everyone in the firm with the exception of ancillary staff.

## Conduct Rules - Pillar 3

Conduct Rules aim to shape the culture, standards and policies of a firm and promote positive behaviours. They also act as a deterrent against misconduct that could have a material impact on customers, the firm or financial markets.

Firms are responsible for ensuring that relevant employees are aware of their obligations under the Conduct Rules, including training in the relevant expectations and responsibilities. Training staff on the Conduct Rules is now a prescribed responsibility for Core and Enhanced firms.

Should the Conduct Rules be breached at any time, the FCA must be notified.

## What are the Conduct Rules?

The Conduct Rules are broken into two categories:

### Senior Management Conduct Rules (applies to SMF holders only):

- SM1 Ensure effective control
- SM2 Comply with regulation
- SM3 Appropriate delegation
- SM4 Disclose appropriately

### Individual Conduct Rules (applies to everyone except ancillary staff):

- Integrity
- Due skill, care and diligence
- Co-operate with the regulator
- Treat customers fairly
- Market conduct

## Fitness and Propriety requirements - Pillar 4

Firms should ensure Senior Managers, those holding Certified Functions and Non-Executive Directors (NEDs) meet Fit and Proper requirements.

Fit and Proper requirements include:

- Adequate training, qualifications, competencies and personal skills.
- Criminal records checks – a Disclosure and Barring Service check must be completed for NEDs and Senior Managers. Any criminal record, including relevant spent convictions, must be disclosed to the FCA. Equivalent checks should be completed in equivalent territories where relevant. While this is not currently mandatory for Certification Functions it should be viewed as best practice.
- Regulatory references - NEDs, Senior Managers and those falling under the Certification Regime must provide employment references from the last six years to include:
  - information in a standard template
  - data from the last six years including details of any disciplinary action due to a breach of the Conduct Rules, upheld complaints or annual Fit and Proper findings
  - details concerning serious misconduct.

These requirements are defined through the new Regulatory Reference rules and it is mandatory that all firms include the appropriate detail.

# Proposed conversion arrangements

The FCA's December 2017 consultation paper outlined a streamlined conversion process for all affected firms. The move aims to simplify the transition to the SM&CR and make the programme more manageable for the FCA.

## Core and Limited Scope firms

The FCA have proposed an automated conversion process to transition Core and Limited scope firms to the new regime. The FCA will automatically convert individuals under the APR to the corresponding SMF wherever possible. Some roles will now be Certified Functions and no longer subject to FCA approval. Every converted Senior Manager must have a SoR even though they are not required to be submitted to the FCA on conversion. No additional checks on individuals are required and firms will continue to ensure they are Fit and Proper.

The role of non-executive chair is a key exception to automatic conversion. In this instance, firms must submit a Form K to record the change. This is because all Non-Executive directors, regardless of their role, were previously approved under CF2, so this is necessary to clarify that they are performing a chair function.

## Enhanced Firms

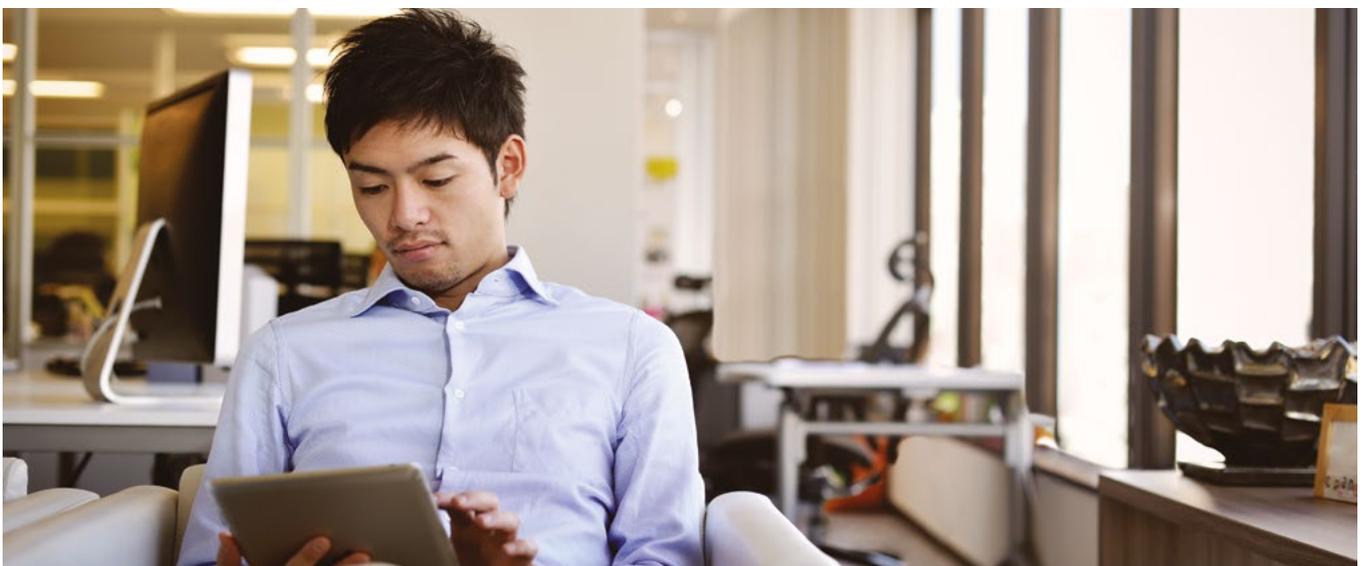
Individuals at Enhanced firms will need to submit a Form K conversion notification, SoR and a Responsibility Map to convert an existing approved individual to a new SMF.

The role of an Executive Chair will be created as an additional controlled function.

## Transitional arrangements

Core and Limited Scope firms will need to check the updated Financial Services Register after the start of the new regime to ensure they hold the correct approvals after automatic conversion has taken place.

The FCA plan to gradually implement rules for certification, so firms can get used to applying the new regime. Once a year firms will need to certify their staff are Fit and Proper for their roles even if the individuals were in these roles before the Certification Regime comes into force, or were approved by the FCA under the APR.



# What should firms do now?

To prepare for SM&CR, firms should assess how the regime will affect their infrastructure and organisational arrangements in the long term. Firms should also address how SM&CR will drive cultural attitudes and conduct on an ongoing basis.

## Lessons learned from the initial SM&CR roll out

Lessons learned from the initial roll out to banks, building societies and credit unions offer valuable insight for businesses affected by the extension. Typically, firms underestimated both the time needed and scale of resources required to effectively implement the framework. In many cases this resulted in the need to make significant organisational and infrastructural changes, together with supporting amendments to governance arrangements.

## Key considerations for firms include:



### Organisational

Firms should consider how SM&CR will affect their organisational structure including:

- Entity structure
- Category of firm
- Offshore implications
- Personnel captured
- Governance committees
- Communication plan
- Allocating/negotiating responsibilities
- Ownership of SM&CR
- Review the role of Non-Executives



### Infrastructure

Essential elements of infrastructure will also be affected and firms should review the following areas:

- Map of management function
- Responsibilities map
- Statement of responsibilities
- Offshore personnel
- Job descriptions
- Training – conduct and regime
- Documentation – including handover, regulatory references, CVs, qualifications
- Document retention mechanism
- Fit and Proper checks
- Capture of disciplinary reporting



### Business as usual

Once implemented, SM&CR implementation will continue to evolve as the business changes with the following events:

- New hires
- Internal transfers
- Leavers
- Promotions and demotions
- Role changes
- New or changed business products
- Reporting of disciplinary actions
- Regulatory changes
- Role absence
- Succession planning
- Code staff tracking
- Conditional approval tracking
- Approval process

Supported by internal audit oversight

# How can we help?

Grant Thornton recognises that implementing the new regulatory framework may prove to be onerous and time consuming for firms. Our team of experts have extensive experience and are able to provide an unparalleled service, underpinned by keen regulatory insight and a commitment to strong client relationships.

Our specialists offer best in class regulatory expertise, supported through extensive work across the financial services sector and with UK regulators. This wide ranging capability is supported by proactive horizon scanning, expert SM&CR knowledge and experience of assisting firms in the implementation of the first wave of the framework. With a strong understanding of the types of challenges many firms face around SM&CR, our skilled team bring up to date insights to add genuine value across your business.

We can provide assurance around implementation plans and ongoing SM&CR programmes. Our subject matter experts can offer assurance and specialist support over the following areas:

- Organisational structures and responsibility mapping
- Governance forums
- Gap analysis and planning
- Resource augmentation
- Offshore implications
- Infrastructure including policies, procedures and mandatory form arrangements
- Employee awareness
- Training
- Embedding and understanding conduct and cultural change
- Assurance programmes
- Conversion processes

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