Grant Thornton
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How to thrive in the new regulatory climate

A guide to the Senior Managers and Certification Regime

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1. Introduction

On 26 July 2017, the FCA published its long awaited consultation paper on extending the Senior Managers and Certification Regime (SM&CR) – already applied to deposit takers and insurance firms since March 2016 – across about 47,000 solo-regulated firms[1]. The proposed regulations represent a profound change in the UK regulatory structure and will have a material effect on all regulated firms, in their relationship with the regulator, in the way they operate, and in their relationship with those who work for them.

Alongside this, the FCA and PRA published companion papers on how the SM&CR should now apply to Insurers[2]. Although presented separately, the proposals for Insurers are closely aligned with those for solo-regulated firms. Aside from a short section in the Overview, we have not therefore made a fundamental distinction between Insurers and solo-regulated firms.

These consultations closed in November 2017, and shortly afterwards, in December, the FCA and PRA published their consultations on the transition arrangements for moving into the new regime. These consultations closed on 21 February 2018.

What the handbook offers

This SM&CR handbook provides you with a route map through the new accountability regimes, including a summary of what it will mean for your firm. But, reflecting the profound nature of this new regulatory approach, it also aims to dig below the surface and provide insight into how it may change the way your firm operates – practically and behaviourally – and how the regulator may apply it.

This insight comes firstly from our study of the FCA's consultation paper, and also from our experience of working with firms going through the first wave of the SM&CR (deposit takers and insurers), and our deep knowledge of how regulators work in practice and the motivations that drive them.

We also include key messages and things to watch out for, and provide some examples of what compliance with the SM&CR will involve. This 2nd edition of the Handbook includes new chapters on both the transition arrangements themselves and on what we have learned from discussions with firms and the regulators during the consultation. We have also updated the chapter on "How regulators may apply SM&CR in practice" with two further predictions.

The way ahead – what to watch out for

The FCA's original plan was for this second wave of the SM&CR – essentially covering all solo-regulated firms, while also extending the Certification regime to Insurers – to come into force in 2018. However, a series of delays has meant that the consultation paper (CP) was published at the end of July, rather than in Q1 as originally intended, and final rules are now not due to be made until summer 2018. Given the likely scale of the work demanded by Brexit and the expected demands the SM&CR will make of the FCA's Authorisation function, we believe it is now unlikely the new regimes will substantively come into effect until the UK leaves the EU in March 2019.

These delays were probably prompted by the difficulties of designing a regime that could be applied across the FCA's regulated population of organisations – from firms such as BlackRock at one end to dentists and vets at the other – with some credible degree of proportionality. Given the requirements of the legislation (for example, that all firms should be subject to the Certification regime), the FCA has probably gone as far as it can in tailoring the SM&CR for different sizes and complexity of firm. However, all but the largest firms are likely to find it a significant drain on their administrative resources, and not just in the set up.

The other cause for delay in the consultation paper's publication was of course the general election, and it would be unwise not to assume that there may be other twists to what has always, from its origins, been a very political narrative. One obvious example is the likely impact the publication of the FCA's first SM&CR enforcement cases will have.

[1] CP17/25 Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms

[2] Although a version of SM&CR referred to as SIMR – has applied to Insurers since March 2016, this is essentially an adaptation of the Approved Persons Regime (APER) and did not, for example, include the Certification regime. The new proposals would apply the SM&CR in full to the sector.

Although we believe implementation is not likely to be until 2019, we would advise firms to start thinking now about its implications for them, both directly and in their future relationship with the regulator. This is not primarily for the usual reason of needing to ensure the necessary changes to business systems and processes are completed in good time. Rather it is because the long-term cultural impact of the SM&CR is likely to be significant for many firms and there is a risk of creating unwanted incentives and consequences if sufficient thinking is not done up front.

There are two main reasons for this. The first is that the SM&CR was originally targeted only at the biggest banks, and extending it to all regulated firms has major implications for both the scale and uncertain nature of its impact. The second is that, despite its various detailed requirements, the SM&CR is, in its philosophy, the antithesis of tick box regulation. As such it will affect the behaviour of all those subject to it; despite the title, this will include (because of the reach of the Certification regime and the individual Conduct Rules) all your staff apart from those in a defined set of ancillary roles.

How we can help

Grant Thornton can help you in a number of ways, including:

- Advice on what are the main compliance approaches open to you, together with our view of the potential impact of each on your firm's culture and values
- Assessment of potential gaps in your current accountability arrangements compared to the SM&CR's requirements
- Assessment of the potential impact on your organisational structures, governance and decision making
- Assistance with implementation including project and change management, and tools to help measure its impact
- Assistance with embedding change, including the operational and cultural impact, both across your organisation and in areas (for example, human resources, training, front office) where this is likely to be most acute
- Assurance that the implementation has been completed successfully and is meeting the aims you identified for it.

If you would like to discuss the SM&CR with us, please contact: **Laila Zaied** on **+44 (0)207 865 2310 .**

The contact details of our core SM&CR team are at the back of this handbook.

2. Background

The wider context

The SM&CR is the implementation by regulatory authorities – the FCA and the Bank of England's Prudential Regulatory Authority (PRA) – of one of the key recommendations of the Parliamentary Commission on Banking Standards (PCBS). The PCBS was established on a cross-party basis, across both houses of parliament, to "consider and report on professional standards and culture of the UK banking sector". Its conclusions were damning and the language of the report reflects the political and public anger of the time.

The **PCBS Report 2013** is one of the cornerstones of Parliament's response to the financial crisis. The others are:

- the **Vickers Commission 2011**, which recommended the ring-fencing of major retail banks
- the **Financial Services Act 2012**, which established a twin peaks regulatory structure of the PRA and FCA, together with a Financial Policy Committee (FPC) to tackle macro-prudential risks
- the **Banking Act 2013**, which transferred consumer credit regulation from the OFT to the FCA

Against this background, the SM&CR emerges as considerably more than a normal regulatory initiative, and it would be no exaggeration to say that its intention is to re-cast the culture of financial services firms and their relationship with the regulators. This explains why many of its measures are so far-reaching and intrusive. It also, in part, explains why the SM&CR is now being applied to almost all regulated firms.

These landmark UK reports and pieces of legislation should also be viewed in the wider context of the international regulatory response, led by the G20 and embodied in the work of the Financial Stability Board (FSB). There are a number of strands to this, typically implemented in the UK via EU directives, including the Capital Requirements Directive IV (CRD IV), the Markets in Financial Instruments Directive II (MiFID II) and the Bank Recovery and Resolution Directive (BRRD).

The SM&CR is in fact made up of several different regimes, and it makes sense to view each as a different "flavour", based around the same core ingredients but each having a different taste and strength. Which flavour applies to your firm will depend on a combination of your size and the regulators' view of the complexity of your business. As far as Parliament's legislation allows, the regimes have been designed by the regulators to be proportionate, but there is an element of "one size fits all" that will demand careful thought in your implementation.

How we got here

The focus of the PCBS was very much the big banks, but when it came to implementing its recommendations, they were always going to be applied across all deposit takers. This is a function of how the legislation works, with firms classified according to the regulated activities they undertake. As a result, not only small banks but also Building Societies and Credit Unions were caught.

The next stage of scope extension took the regime across to Insurers. The prudential supervision of the sector had been transferred to the PRA on the basis that the largest of these firms were systemically important. Therefore, the logic of also applying a version of the SM&CR to these firms was straightforward, and had the additional advantage of simplifying the PRA's approach so that it would not need to treat the two sectors differently.

The next step, deceptively simple but with wide-ranging implications, was to apply the SM&CR to the systemic investment firms the PRA supervised, such as JP Morgan and Goldman Sachs. This meant that the tip of another large sector was affected, and it also created two further regulatory dilemmas: what to do with other investment firms; and how to approach the issue of accountability in other sectors, such as asset management.

In the end, the conclusion was that the SM&CR would be a clear benefit for regulation across the board. And so what originally focused on the (lack of) individual accountability in banks such as RBS and HBoS, came to be seen as a solution for all regulated firms. The latest FCA consultation paper is therefore the final, and by far the largest and most ambitious, phase of the SM&CR. We should not be surprised by this. Once the existing Approved Persons Regime (APER) had been comprehensively criticised by the PCBS, its days were numbered. And it made no sense to then invent another new regime, adding complication, when there was already the option of SM&CR as a ready-made alternative, in effect pre-approved by Parliament.

What's really different?

Very little in regulation, as in other aspects of life, is truly new, and so it is worth taking a look at what the APER was meant to be about when it was introduced and what were the significant cracks that became apparent over time.

Back in 2000, the FSA, the newly-formed regulator, produced its manifesto for the future of regulation: "A new regulator for the new millennium". In this document it stated that: "*Vetting at entry aims to allow firms and individuals who satisfy the necessary criteria (including honesty, competence, and financial soundness) to engage in regulated activity.*"

While the tone is more measured, the original purpose of the APER was similar to that of the SM&CR. It is true that the latter catches fewer people in Senior Manager Functions (SMFs) than APER did in Controlled Functions (CFs), but it more than makes up for this by introducing the Certification Regime, which all firms must administer and police themselves. How this will play out in terms of giving the SM&CR a sharper focus than its predecessor will only reveal itself with time.

We see six areas where the effectiveness and impact of the SM&CR will be determined. Whether the government and the FCA ultimately conclude that the SM&CR has been a success will largely be driven by how well the regulator handles these challenges:

1. **Enforceability:** Despite the rhetoric, it is not clear how much easier it will be in the new regime to hold individuals to account for the kind of failures that helped cause and then exacerbate the financial crisis.
2. **Barrier to entry:** Individuals already in role will almost all be "converted" into SMFs, but as these role-holders move on the regulators will face the question of whether they want to raise standards, and if so in what way.
3. **Talent pool:** Related to this is the question of whether there are enough suitably qualified people to perform SMFs, and whether the existence of the regime may deter even the good candidates from signing up. And within this there are further questions of diversity and group think that regulators haven't yet resolved.

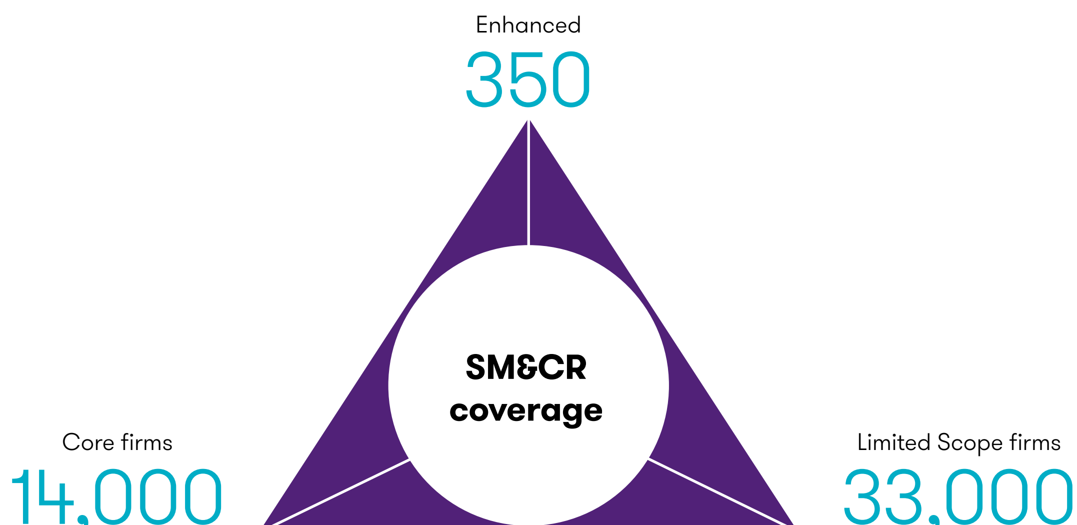
4. **Resourcing:** Authorisation is at the volume end of regulation and it is not clear that, despite the reduction in the number of directly approved positions, the SM&CR will make fewer demands on it. In fact, the requirements around policing Statements of Responsibility and regulatory references may require more resource than the APER.
5. **Enforcement:** The PRA will have a major interest, but in reality the FCA is the regulator with the large enforcement function, and both the nature and outcomes of the first major SM&CR cases it brings will set the tone and precedents for what follows. The regulatory appetite for losing important cases is inevitably low and individual cases have to meet a higher legal test than corporate ones. The APER proved hard to enforce against, so will SM&CR prove stronger in practice?
6. **Priorities:** Regulators' agendas are as busy as ever, partly imposed and partly by choice. Over time, the APER became less of a priority, the pre-approval of Paul Flowers as Chair of Co-operative Bank being the most obvious example. In a world of finite and increasingly flat resourcing, there is a significant risk that the SM&CR could meet the same fate. If so, it will herald some unpredictable consequences for firms.

One of the key differences, though it will only apply formally to those firms that are in the Enhanced regime, is the concept embodied in a "Responsibilities Map", that the Senior Managers of a firm should between them cover all its activities. In contrast, the Core regime reverts to the APER idea that the activities which matter will be covered by the key SMFs. This dilution is a key element of the SM&CR that the FCA has introduced in order to make it more proportionate for smaller firms, and it will be interesting to see the wider reaction if a Core firm collapses and senior manager accountability is perceived to have fallen through the cracks.

Another key difference is the requirement on holders of SMFs to take "reasonable steps" to prevent or minimise a breach of regulatory requirements. Defining and documenting these, particularly in the heat of dealing with such a breach, may become the subject of considerable soul-searching for all concerned, including the regulators trying to make after-the-fact assessments.

The other differences worth noting at this stage are the requirements around the annual renewal of certifications and the provision of regulatory references to future employers. Both of these are likely to alter the relationships between firms and their employees and to create significant new layers of administration.

Each of these aspects is discussed in more detail in subsequent chapters.



3. Overview

The big picture

As already noted, the FCA is providing different versions of the SM&CR for firms of different scale, complexity and risk to its objectives. The FCA refers to these as different SM&CR regimes. In total there are broadly six regimes of the SM&CR which could apply, with differing mandatory elements in each case.

Any firm that is regulated by the FCA, and which is currently subject to the APER (and therefore has individuals authorised by the FCA to hold CFs) will be subject to the SM&CR. The regime applies at the level of individual entities, and therefore, where there is a group of regulated firms, the assessment of which SM&CR regime applies must be made for each individual firm.

The six regimes of SM&CR which the FCA have set out are:

1. Bank (deposit takers) / Systemically important Investment firm
2. Enhanced (including Insurance Solvency II Firms and Large NDFs[3])
3. Core (including other UK Insurers)
4. Branch – non-European Economic Area (non EEA) firm
5. Branch – European Economic Area (EEA) firm
6. Limited.

This is a slightly simplified version, which we believe provides the greatest level of clarity about the regulations that are being implemented. However, you should be aware of the following:

1. The FCA has published a separate consultation paper for Insurance. In practice, however, the SM&CR elements for Solvency II firms and large NDFs are essentially the same as for the Enhanced regime
2. Likewise, the elements of the SM&CR that apply to the Core regime also apply to other UK Insurers
3. There is no limited regime for Insurers.
4. The SM&CR elements for EEA and non EEA branches are the same for Insurers as for other firms.

With five exceptions, all the 17 elements of the SM&CR apply to all UK-regulated firms. Of these five exceptions, four are restricted to Enhanced firms and one applies to the Enhanced and Core but not to the Limited regime. On one level, therefore, the proportionality is applied within the elements rather than between them and this is likely to increase the practical complexity of applying them. However, you should also note the following points:

1. The four elements that apply only to Enhanced firms are among the most onerous, requiring firms to map out all their activities and apportion them across their SMFs
2. the number of required SMFs varies enormously between the different regimes.

[3]Non Solvency II Directive insurance firms For branches (EEA and non EEA), the Certification regime and functions are limited to UK-based staff

The table below summarises which elements of the SM&CR apply to each of its constituent regimes:

Table 1: How SM&CR Elements apply across the different regimes

SM&CR elements	Banks	Enhanced (including Solvency II Insurers and Large NDFs)	Core (including other UK Insurers)	Limited	Non EEA Branches	EEA Branches
Responsibility Maps	X	X				
Overall Responsibility	X	X				
Other overall Responsibility	X	X				
Handover Procedures	X	X				
Senior Managers Regime	X	X	X	X	X	X
Senior Manager Conduct Rules	X	X	X	X	X	X
Senior Management Functions	X	X	X	X		
Statement of Responsibilities	X	X	X	X		
Duty of Responsibility	X	X	X	X		
Prescribed Responsibilities	X	X	X			
Criminal records checks	X	X	X	X		
Certification Regime[4]	X	X	X	X	X	X
Certification Functions	X	X	X	X	X	X
Fit and Proper Requirements	X	X	X	X		
Regulatory references	X	X	X	X		
Individual Conduct Rules	X	X	X	X	X	X
Ancillary staff	X	X	X	X		

Insurance firms

The great majority of insurance firms will become subject to regulations equivalent to the Core regime, while the largest[5] will be subject to an Insurance version of the Enhanced regime. The proposals for branches are likewise very similar to those for solo-regulated firms.

There will be differences in the detailed rules, reflecting, for example, the requirements of Solvency II, but the two consultation papers are very closely aligned. The greatest distinction may lie in the way the regimes are supervised, reflecting the fact that Insurers are dual-regulated by the PRA as well as the FCA.

[4]For branches (EEA and non EEA), the Certification regime and functions are limited to UK-based staff

[5]Solvency II firms and Large NDFs

Summary of chapters

Firm Classification – Which regime / "flavour" applies to your firm?

This chapter will help you understand which flavour of the SM&CR will apply to your firm and why. The easiest way of approaching this is to assume you are in the Core regime unless you meet a threshold for one of the others.

Most of the categories are defined by your firm's structure and the activities for which it is regulated, and as such the different classifications are relatively fixed. The exception is the threshold between Core and Enhanced regimes, which firms can move across as they grow (or reduce) in size.

Senior Manager Regime

Because of the proportionate way the FCA is seeking to apply the Senior Managers regime, its impact will vary greatly depending on whether your firm is subject to the Enhanced requirements. These are therefore examined in more depth.

This chapter summarises the relevant changes, and examines in more detail the aspects your firm may find most difficult and resource-intensive. It also considers how the Senior Managers regime may change the way your firm operates and the consequent risks you may need to manage.

Certification Regime

This is perhaps the most far-reaching change and, although it has received less comment, will probably have the greatest impact on how your firm operates. The philosophy behind the SM&CR is that the regulator will target a much smaller number of senior managers than the APER did, those with real responsibility, and that firms should then be responsible for confirming ("certifying") that they are suitable to perform their role. For most firms, the sum of SMFs and Certification Functions will be greater than currently covered by the APER.

This chapter explains these differences in coverage and the new areas and new groups of staff this regime will cover. In doing so, it highlights the main issues you are likely to encounter during implementation.

Transition arrangements

This covers the second wave of consultations, which describes how firms will be transitioned into the new regime, and what this will mean for Enhanced firms as contrasted with those in the Core and Limited regimes.

In this context, it will look at the implications for firms' preparations, both when they should start their projects, if they haven't already, and the importance of sequencing them correctly.

Insights from the consultation period

During this period, we met with many firms and also had several discussions with regulators about the underlying purpose of particular proposals, the likely impact of SM&CR on firms and their business models, and the challenges of implementation.

This chapter sets out our main conclusions from these discussions and offers some broad recommendations to firms as to how they should approach their implementation projects.

Fit and Proper Requirements

This chapter explains how these are being extended to certified staff, and the regulator's expectations of what this will involve. In particular, it will looks at what the introduction of regulatory references is likely to mean for your firm, both administratively and culturally.

It will also discuss the likely interplay between these requirements and the annual certification process described in the previous chapter.

Conduct Rules

This chapter explains the difference between the two tiers of Conduct Rules – those that apply to all the people who work for your firm (with the exception of a defined list of ancillary roles) and those that apply only to Senior Managers.

It also explains how the individual rules are a significant extension of scope compared to the APER, and highlights the main ways in which the regulator will expect these rules to "achieve culture change across organisations".

Transitions arrangements

This chapter will look at how firms go about the conversion of their existing CFs from the outgoing APER into the SM&CR as SMF holders.

It also covers the second wave of consultations, which describes how firms will be transitioned into the new regime, and what this will mean for Enhanced firms as contrasted with those in the Core and Limited regimes.

In this context, it will look at the implications for firms' preparations, both when they should start their projects, if they haven't already, and the importance of sequencing them correctly.

How regulators may apply the SM&CR in practice

This chapter explains how the regulator is likely to apply SM&CR in practice. This will depend in part on the size and complexity of your firm but also on the way in which the FCA prioritises different issues, and the resources – both specialist and generalist – it has available.

It will also discuss the relationship between different parts of the FCA over policy areas such as the SM&CR. There are some issues where individual parts of the FCA can take action on the basis of their own priorities. However, on other issues, probably the majority, significant collaboration is needed, and this often affects the timing and type of intervention the FCA makes.

Insights from the consultation period

During this period, we met with many firms and also had several discussions with regulators about the underlying purpose of particular proposals, the likely impact of SM&CR on firms and their business models, and the challenges of implementation.

This chapter sets out our main conclusions from these discussions and offers some broad recommendations to firms as to how they should approach their implementation projects.

4. Firm classification:

Which regime/"flavour" applies to your firm?

Introduction

The first step in implementing the SM&CR is to determine which type of firm you are and therefore which SM&CR regime applies. The great majority of regulated UK firms will be in the Core or Limited regimes. The FCA estimates that less than 1% will be subject to the additional Enhanced requirements, while those subject to the limited application of the APER will move across to the Limited regime of the SM&CR. For UK branches of overseas firms, the normal distinction between EEA and non EEA applies.

As would be expected, the complexity of the regime increases as it moves from Limited through Core to Enhanced firm categories. However, based on our experience of the first wave of the SM&CR, the *relative burden* on the firm or individual SMFs may be greater in the smaller, simpler firms. This is the outcome of the interplay of several factors. Larger firms tend to have more resources to bring to bear; their structures are often already characterised by specialisms which tend to align with the expectations of the SM&CR; and many will have had greater ongoing touchpoints with the regulators, and so will have better insights into the regulatory mindset. By contrast smaller firms will have a concentration of accountability in a few individuals. Whilst it is true that it will be straightforward for these firms to identify who needs to be an SMF, this will be a small number of individuals and each of these may be accountable for a much larger range of diverse activity than is true in larger firms.

This chapter takes you through each of the SM&CR regimes in turn.

Enhanced

The criteria for being part of the Enhanced regime (see Table 2) have been designed to capture only the largest, most complex solo-regulated firms, those that the FCA believes carry the greatest potential risk to their objectives. The regulator believes there are only about 350 of these firms, although as the criteria are fixed values this number is likely to rise over time.

Table 2: Criteria for Enhanced firms

Category of firm	How to tell if this applies
A "Significant" IFPRU firm [FCA estimates about 100 firms]	IFPRU firms are typically more sophisticated investment firms or those which trade on their own account. These firms are subject to particular capital rules which are set out in the IFPRU handbook. Significant IFPRU firms are those which pass certain size thresholds set out in IFPRU 1.2.3. These thresholds are: • Total firm assets >£530 million • Total firm liabilities >£380 million • Regulated fees and commission income >£160 million a year • Holds client money >£425 million • Holds client assets >£7.8 billion Passing any one of these thresholds at any time qualifies the firm as "Significant".
A "Large" client assets sourcebook (CASS) firm [the FCA estimates about 15 firms]	These are firms which hold client money and/or client assets under the safe custody rules set out in the CASS handbook. A "large" CASS firm is one which holds either: • Client money >£1 billion • Client assets >£100 billion The CASS status of a firm, for instance moving from a CASS "medium" to a CASS "large" firm, is reassessed by the FCA and becomes effective once a year in February, unless the firm elects to make the change at another time.
A firm with assets under management >£50 billion at any time in the past three years [the FCA estimates about 110 firms]	A portfolio management firm which has third-party assets under management of more than £50 billion, or has had that amount at any time in the past three years. The FCA identifies this as the amount the firm will have included in data element 1A of its FSA038 submission. This will capture the largest discretionary investment managers and managers of collective investment schemes. There is a carve out that will exclude Alternative Investment Fund Managers from being captured by this threshold as long as they do not manage regulated funds, or only market their funds to professional clients.
A firm with >£35 million a year revenue from regulated intermediary business [the FCA estimates about 75 firms]	A broker or advisory firm that has more than £35 million a year of revenue from its intermediary business. The FCA identifies this as the amount the firm will have included in data element 4E of its retail mediation activities return (RMAR) submission.
A firm with >£100 million a year revenue from consumer lending [the FCA estimates about 25 firms]	A non-bank lender with annual revenues from regulated consumer credit lending exceed £100 million. The FCA identifies this as the amount of the total of data items listed in column B of its CCR002 submission.
Non-bank mortgage lenders with >10,000 outstanding regulated mortgages [the FCA estimates about 25 firms]	A non-bank lender with more than 10,000 live regulated mortgage contracts (excluding commercial mortgages) on its balance sheet. The FCA identifies this amount as the total of data items in row E4.5 and row G1.1(d) in its mortgage lenders and administrators return (MLAR) submission.

If you are an Enhanced firm, you will need to designate a significantly larger number of SMFs (see the next chapter), but the biggest difference will stem from the obligation for these to cover all your firm's activities. As a result, the Enhanced regime will be much closer to the regime that applies to banks[6], and equivalent to the one that will apply to the largest Insurers[7].

This means you will have to produce and keep up to date a Responsibilities Map[8], which shows how responsibility for your firm's activities are apportioned between the various SMFs. This is perhaps the biggest conceptual difference from the APER, which, as the Core regime still does, focused on a number of key roles and therefore left gaps where the responsibility for some activities was not allocated.

[6]This regime includes other deposit takers

[7]that is, Solvency II firms and Large NDFs (the FCA estimates there are 19 of these firms)

[8]The other SM&CR elements that apply only to the Enhanced regime are Overall responsibility, Other overall responsibility and Handover procedures

Core

Firms in the Core regime have a significantly smaller number of mandated SMFs than Enhanced firms, possibly as few as five. They will also not be subject to four of the key SM&CR elements, most notably Responsibility Maps. This is a significant attempt to make the SM&CR more proportionate.

However, many of the aspects of the Senior Managers regime, such as Prescribed Responsibilities, Certification Regime, Fit and proper requirements and Conduct Rules do still apply. Firms in the Core regime will therefore face the dilemma of how much resource and new infrastructure to place around the SMFs they do have to ensure their holders can meet their obligations. We understand that the legislation gives the FCA little choice but to apply these in full, however the result is likely to cause significant changes in your firm's culture and the way it operates.

The overall effect places much more explicit responsibility on firms for ensuring their staff are fit and proper, and that records of how this is assessed are up to date. In some instances the evidence to be used is also stipulated, and firms must be able to provide regulatory references on certified staff to their future employers for up to six years. We deal with these requirements in detail in later chapters.

Transitions

Firms can move between the Core and Enhanced regimes if they cross the relevant thresholds. In each case there is a transition period – six months for firms moving to Enhanced and a year for those moving to Core. The start of this period varies depending on which threshold is triggered. Transitions may occur for other reasons, such as acquiring authorisation, either as an unregulated entity, or as a regulated firm acquiring new permissions, and in the course of doing so changing the SM&CR regime (for example, becoming a deposit taker or a benchmarking firm).

In all these situations we would advise you to consider carefully what impact the SM&CR is likely to have and to prepare for that impact well in advance. This is not only because initial implementation is likely to be a significant programme of work that it would be costly to have to repeat, but also because the likely changes in cultural behaviours will take time to embed.

i. Moving from Core to Enhanced

The FCA has reserved the power to require firms which do not meet any of the Enhanced regime thresholds, but which it feels are large and complex enough to pose a high risk to consumers or markets, to take on the Enhanced regime obligations. This will be most likely be done under its initiative requirement process.

Until there are examples of the FCA using this power, it is difficult to predict exactly when it will apply. Firms with multiple business lines, which do not pass any of the Enhanced thresholds even though the aggregate business is significant, would appear the most likely candidates. The FCA has also said it will use this power on a firm by firm basis. However, it will be difficult for the regulator not to treat similar firms in a consistent way, so we expect precedents to emerge over time as the overall picture becomes clearer.

We also consider that one of the risks a firm will face through its interactions with the FCA is that the regulator, if it has concerns about the quality of management oversight within the firm, may use its power to require the firm to follow the Enhanced regime as a means of remedying those issues. The Enhanced regime will, in these cases, be one of the tools that the regulator may choose to use to improve a firm's governance.

However, we also assume that increasing the number of firms in the Enhanced regime would have material consequences for FCA resources. This is likely to happen in any event: the thresholds are fixed, and the trends to consolidate in various sectors, as well as the growth trajectory of a number of firms and the effect of inflation over time, will tend to push more firms over them.

If you believe your firm is likely to move into the Enhanced regime in the next five years, for whatever reason, we would advise you to think carefully about the effect this would have and to consider preparing well in advance so that the transition can be smooth. Since the SM&CR regimes are unlikely to come into force before the summer of 2019, there would be a strong argument to include this preparation in your initial SM&CR implementation plan.

ii. Moving from Enhanced to Core

Firms can apply for a waiver if they believe their complexity and risk do not warrant being subject to the Enhanced requirements even though they have passed one of the thresholds, and that the Core regime would be more suitable.

The FCA has not set out the factors that would make it likely to grant such a waiver. We expect these will include a threshold being passed only temporarily (that is, it is not expected to be a permanent change in the scale of the business). The most important factor, however, will probably be that the business is simple rather than complex, and so complying with the Enhanced regime would be disproportionate given the size of the management team and number of staff.

However, until there is practical experience of waivers being assessed by the FCA, it is difficult to determine how likely it is that these requests will be successful. The onus will be on the firm to convince the FCA of the merits of the waiver, and the likely inclination of the regulator will be to reject such requests unless the evidence is persuasive.

Limited

The criteria for being a Limited regime firm (Table 3) are largely based on what types of activity the firm undertakes. This regime is intended to cover firms that are currently subject to a limited application of the APER, and these firms will need to have only a small number of SMFs, between one and three depending on the type of firm.

However, firms in the Limited regime are still subject to the full Certification regime and Conduct Rules, and many of the Fit and Proper requirements. It would therefore be wrong to believe that the SM&CR will have little effect, as in many ways these are the aspects that will penetrate deepest.

Much will depend on the size of your firm and the scale of the business you conduct relative to the sector you are in, and the likely degree of regulatory focus you will receive. Thus, a sole trader is unlikely to experience any material difference, however a large but limited permission consumer credit firm may need to implement some significant changes.

The effect on firms in this category will also be determined by how the FCA supervises the SM&CR, particularly when there is a potential conduct failure. In particular, it will need to decide whether, when a problem has occurred, it is able to carry through a proportionate policy approach in a situation that may warrant enforcement action.

Table 3: Criteria for "Limited" regime

Category of firm	How to tell if this applies
A sole trader	The regulated entity is a single individual. This therefore excludes any business that has incorporated, for instance as limited company or as any form of partnership. Sole traders can be one person firms, or the sole trader can employ other individuals who work for them. The key is that they have not incorporated.
A "limited permission" consumer credit firm	There are eight different types of regulated consumer credit activity which the FCA defines as limited permission rather than full permission activity. These limited permission activities are: • Lending where the main business is not financial services and the lending is interest free (for example, golf clubs or gyms where membership fees are deferred in instalments) • Consumer hire (for example, tool or car hire) • Credit broking exclusively for hire purchase or consumer hire agreements • Credit broking where the main business is not financial services (for example, motor dealers or retailers that introduce customers to a finance provider) • Credit booking in relation to the Green Deal (being lending for energy efficient home improvements under the government's Green Deal scheme) • Not for profit debt counselling and adjusting • Not for profit credit information services • Local authorities Remember, any firm that has additional permissions not included on the above list will not meet the criteria for being a limited regime firm.
Insurance intermediaries whose principal business is not insurance intermediation and who only have permission to carry on insurance mediation activity in relation to non-investment insurance contracts	Insurance intermediation is the act of introducing a customer to an insurer for the purposes of buying insurance, or otherwise helping to arrange for this to happen. The most common examples are retailers or car showrooms who offer access to insurance based warranty cover for the products they sell. This definition excludes intermediaries where the insurance they are arranging is effectively an investment.
Internally managed alternative investment funds	These are alternative investment funds (typically hedge funds, although they also include real estate and private equity funds) which are directly authorised and do not operate through a separately regulated management company.
Oil market participants	A firm for which the only regulated activity is participating in wholesale oil markets.
Energy market participants	A firm for which the only regulated activity is participating in wholesale energy markets or in derivatives based on those markets (including emission allowances).
Service companies	These are firms whose only regulated activity is "making arrangements with a view to transactions in investments" where they provide technology infrastructure to regulated market participants, for example, order routing or post-trade processing.
Authorised professional firms whose only regulated activities are non-mainstream regulated activities	These are firms designated by one of the following professional bodies: • The Law Society of England and Wales • The Law Society of Scotland • The Law Society of Northern Ireland • The Institute of Chartered Accountants in England and Wales • The Institute of Chartered Accountants of Scotland • The Institute of Chartered Accountants in Ireland • The Association of Chartered Certified Accountants • The Institute of Actuaries • The Council for Licensed Conveyancers • The Royal Institution of Chartered Surveyors The regulated activity they perform is incidental to their normal business and is permitted by the relevant professional body. This is typically corporate finance or debt adjusting activity. The FCA has specified that certain regulated activities can never be considered incidental, including accepting deposits, underwriting insurance and establishing a collective investment scheme.
Subsidiaries of local authorities or registered social landlords	Any subsidiary wholly owned by a local authority or a registered social landlord.

Firms that qualify for the Limited regime cannot move to the Enhanced regime, even if they cross one of the thresholds for being an enhanced firm. This is only likely to affect oil/energy market traders or large retailers that undertake insurance intermediation – these firms could pass one of the enhanced firm thresholds but, because of the nature of their activity, they would remain subject to the Limited regime.

Branches

Slightly different versions of the SM&CR will apply to EEA and non EEA branches but in most respects they are the same. In particular, both will be subject to the Certification regime and to the Conduct Rules but these will apply only to UK based staff.

The main difference is that EEA branches will be required to have fewer SMFs – only the branch senior manager and the money laundering reporting officer (MLRO), while non EEA branches will also have to include Executive Directors, Partners and Compliance Oversight. At some future stage, we presume this distinction will need to be regularised to take account of Brexit.

Groups

There will be groups containing a number of regulated entities that will be subject to different regimes within the SM&CR. These groups will need to consider carefully whether it is worth effectively gold-plating aspects of it for some of the lower risk entities so as to establish a level of consistency across the group and make the regime as a whole simpler to apply.

Your firm will face a different set of issues if, as a UK regulated firm, it is part of a group where the holding company is either regulated elsewhere or is unregulated. In such circumstances, you will need to think through how you want responsibility and decision making to be apportioned and how this fits with your appetite for senior employees, and potentially non-executive directors, of non UK-regulated entities to hold SMFs and so be subject to UK regulation.

5. Senior Manager Regime

Overview

The Senior Manager regime is the most high profile part of the SM&CR and was a key recommendation of the PCBS Report in June 2013. Its aim is to cover only those individuals in regulated firms who have real responsibility, and so it sets out to be much more focused than the APER which it replaces. The corollary is that the APER roles that are not becoming SMFs are now covered by the Certification regime, which firms are charged with managing themselves.

Table 4 sets out the SMFs that apply across the different SM&CR regimes. Firms that are larger and/or more complex are seen as carrying greater potential risk to the regulators' objectives and are therefore required to have more Senior Manager Functions (SMFs). Banks[9] therefore attract the highest number of SMFs, followed by firms in the Enhanced regime[10]. For the largest of these firms, the regime is likely to feel very similar to banks.

However, the number of SMFs drops significantly for the Core regime, possibly to as few as five. For solo-regulated firms and for Insurers, this is a major attempt by the regulators to ensure the regime is as proportionate as the legislation allows. And alongside this reduction, Core firms are excused several other major elements of the Senior Manager regime, notably the requirement to produce and keep up to date a Responsibilities Map that covers all the firm's activities.

It would be wrong, however, to assume that the impact of the Senior Managers regime is in direct proportion to the number of SMFs your firm is required to have, or that the provision in the consultation paper that would allow individuals to hold more than one SMF each is a straightforward way for a firm to meet its requirements. There are three main reasons for this:

1. The additional level of support and infrastructure larger firms are able to provide to help the firm and its SMF meet the requirements of the regime
2. The related requirements of the Certification regime, which are much less proportionate in relation to a firm's size and therefore can produce a heavier individual burden on SMFs in smaller firms
3. The relative lack of synergy between many of the SMFs, meaning that combining more than one does not of itself lead to a reduction in the size of the overall burden, either on the individuals concerned or the firm as a whole.

Our experience of working with Banks and Insurers who became subject to the Senior Managers Regime in 2016 is that the relative burden was often greater for some of the smaller firms. Despite the introduction of the Core regime, we believe this may continue to be the case, particularly if the thrust of the regime is at odds with the way your firm currently operates.

The other major variable is the degree of interaction your firm has with the regulator. This will tend to be greater for larger firms, both in an absolute sense and in relation to their sector. It will also vary relative to the regulators' evolving perception of the risk your firm and your sector pose to their objectives.

[9]This covers all deposit takers, including building societies, designated investment firms and credit unions, although for the last the requirements are limited
[10]Includes Solvency II Insurers and Large NDFs

Table 4: Senior Manager Functions applicable to different SM&CR regimes

Senior Manager Functions	Banks	Enhanced (incl. Solvency II Insurers & Large NDFs)	Core	Limited	Non EEA Branches	EEA Branches
SMF1 – CEO	X	X	X			
SMF2 – Chief Finance Function	X	X				
SMF3 – Exec Director	X	X	X		X	
SMF4 – Chief Risk Function	X	X				
SMF5 – Head of Internal Audit	X	X				
SMF6 – Head of Key Business Area	X	X[11]				
SMF7 – Group Entity Senior Manager	X	X				
Smf8 – Credit Union Senior Manager[12]	X					
SMF9 – Chair	X	X	X			
Smf10 – Chair of Risk Committee	X					
SMF11 – Chair of Audit Committee	X	X				
SMF12 – Chair of Remuneration Committee	X	X				
SMF13 – Chair of Nominations Committee	X	X				
SMF14 – Senior Independent Director	X	X				
SMF16 – Compliance Oversight	X	X	X	X	X	
SMF17 – MLRO	X	X	X	X[13]	X	X
SMF18 – Other Overall Responsibility	X	X				
SM19 – Head of Third Country Branch					X	
SM20 – Head of Actuarial[14]		X	X			
SM21 – EEA Branch Senior Manager						X
SMF24 – Chief Operations Function		X				
SMF27 – Partner		X	X		X	
SMF29 – Limited Scope (Apportionment & Oversight)				X[14]		

[11]Insurers only
[12]Credit Unions only
[13]Does not apply to sole traders
[14]There are a number of SMFs specific to insurers, of which this is one.
Please refer to the relevant FCA and PRA CPs for more details

Key messages

There are six key messages it is worth holding in your minds when looking at the detail of SMF roles and considering how best to implement them within your firm:

1. **Fewer is not always better:** The temptation will be to have as few SMFs as the regulations allow but this may not always be the best option for the firm or its future relationship with the regulator, let alone for the individuals concerned. There are three potential reasons for this:
   i. it is not the best fit with your current values and culture (see below)
   ii. it downplays the role senior individuals not including as SMFs have in ensuring regulatory compliance
   iii. it places a disproportionate burden on a small number of individuals
2. **Underlap is as important as overlap:** Most firms, for efficiency reasons, are keen to delineate between the responsibilities of their senior staff, and the SM&CR's focus on individual accountability reinforces this. However, avoiding underlap can be just as much of a danger and you should stress your model by testing what sorts of events could be deemed no one's responsibility. This applies, albeit in different ways, whether you are in the Core or the Enhanced regime.
3. **Focus on the hand-offs:** Most important matters do not naturally remain the responsibility of the same person throughout their lifecycle. Instead, they pass between senior staff as they mature, become better understood, or require a new approach. However, a common issue is that when these issues move across, they do not always retain the same priority, either because the person receiving has their own priorities or because its importance has not been properly explained. Getting these transitions right is one of the keys to successful implementation of SM&CR.
4. **Committees will need to operate differently:** Notwithstanding their terms of reference or who is the Chair, most committees tend to operate with a degree of collective responsibility. This will need to change below the level of the Board, because the responsibility for decisions in a certain area will, in the regulator's eyes, rest with an individual SMF. You should therefore think carefully about the implications for who is Chair of your various internal committees, their terms of reference and (see below) how their meetings are recorded.
5. **SMFs will need support:** The nature of this will vary by firm but it would be a mistake to assume individuals can carry the additional responsibility of an SMF without help. Even if the current incumbent has been in place so long that they are personally comfortable, you should think carefully about the future attractiveness of the role to potential successors.
6. **Make sure incentives are aligned:** A common source of misunderstanding between firms and the regulator is the difficulty they can experience in seeing actions and events from the perspective of the regulator's objectives. Bridging this for individual SMFs, so that they are easily able to understand the regulator's approach will be one of the key challenges, and is often most effectively addressed by aligning incentives for each SMF with their accountabilities. This includes having mechanisms in place to reduce incentive payments where an accountability that the regulator will consider significant is not met.

Impact on culture

The PCBS Report in 2013 was subtitled "Changing banking for good" and many of its recommendations, including those that have led to the SM&CR, were targeted at changing the culture in banks. As a matter of principle, you should therefore assess how closely your firm's values and culture are aligned with the SM&CR. This applies no matter how confident you are in how your firm currently operates.

The regulator's view of the SM&CR is that it reflects existing good practice, and that well run firms should therefore have to change relatively little to meet its requirements. The reality is likely to be more complicated for many, who will find the clean lines of responsibility described in the consultation paper a simplified version of their experience. There are a number of potential reasons for this, each with greater or lesser justification, partly depending on the nature of the firm. They include the following:

- A flat, collegiate senior management structure, with the majority of decisions made by consensus
- Influential senior figures who have much more influence than job title or formal responsibilities would indicate
- A complex matrix, where the execution of formal decisions is dependent on the agreement or provision of resources from another part of the organisation
- There is a dominant chief executive, so that the real decision making of senior managers is much less in practice than it would appear from the structure
- The business is highly technical and/or fast moving, and many of the key decisions are made by specialists on the ground, having been informally delegated by senior managers who may be less technically expert
- Decision making is complex and highly formalised, with multiple sign offs and amendments to the original, so that ultimate responsibility is effectively collective

If your firm's culture resembles one or more of the above, and the list is far from exhaustive, then the SM&CR will have a substantial effect.

In reality, the regulator understands that different types of firms will need to implement the SM&CR in different ways, and will look for ways it can be sympathetic to this without losing the essence of the reforms. As a minimum, you should be able to explain how the SM&CR fits with your culture as the regulator understands it, and any changes you are making to align the two more closely.

This should take account of your recent regulatory history and any conduct failures in your sector over the last couple of years. It should also take care to reflect how responsibility for known future regulatory changes will be apportioned.

Practicalities

There are three main steps towards introducing the SMF component of the Senior Manager regime, four if you are part of the Enhanced Regime. In order of difficulty, these are: (i) identifying SMFs; (ii) allocating Prescribed Responsibilities; (iii) drawing up Statements of Responsibility; and (for Enhanced firms) (iv) preparing and maintaining a Responsibilities Map (and Handover procedures).

i. Identifying SMFs

The great majority of the mandatory SMFs, whether Core or Enhanced, are straightforward to identify, conform to commonly used job titles, and in many cases they (almost) mirror exactly existing CFs under the APER (see Table 4). Assuming the responsibilities of each role are distributed normally, the only real debate should be around one of the Core SMFs and three of those that are confined to Enhanced firms, one of which only applies to large Insurers. Taking these in turn:

- **Executive Director (SMF3):** On the face of it, this Core SMF should be a straightforward decision reflecting the current senior structure of your firm. However, once you start allocating Prescribed Responsibilities and drawing up Statements of Requirements (see below), you might decide that you have too few or too many, or that there is a mismatch between responsibilities and job title.

- **Group Entity Senior Manager (SMF7):** This Enhanced function applies to people who have significant influence on a UK-regulated entity but are employed by another group entity even if they are not themselves regulated (or are regulated elsewhere). When considering whether your firm should have these positions, and if so how many, you will want to consider a number of factors. These will probably include how complex you want your management structure to be, and whether it reflects how the business operates in practice. However, if the firm relies heavily upon another group entity (regulated or not), it is likely that individuals from that entity will be in scope. In this context, it is worth noting that there is explicitly no territorial limitation on this part of the regime, so senior managers outside the UK could be drawn in as SMFs.
- **Other Overall Responsibility (SMF18):** This applies only to Enhanced firms where the person ultimately responsible for a particular area holds no other SMF function. If this is the case, and the firm does not want the area they are responsible for falling to the next most senior individual's SMF accountability, then allocating SMF18 will extend the number of SMFs (and reduce the concentration of accountability that might otherwise occur for a smaller number of individuals). It is the obvious way a firm can cover its activities so as to enable it to produce a credible Responsibilities Map (see below). This is another instance where the process of understanding fully where responsibility really sits in your firm may lead you to question whether you have attached the right level of seniority to certain roles.
- **Head of Key Business Area (SMF6) Insurance only:** The application of this SMF role is similar to the SMF18 role described above. It is intended to capture heads of significant units who would not otherwise be one of the other designated SMFs in the Insurance regime. It will allow accountability to be extended to additional individuals where the Insurer does not feel it appropriate for the accountability to be concentrated in the next senior individual in the upwards reporting structure.

It is worth noting that the regulator will expect the Senior Manager regime to capture the most senior people in your organisation, so any exercise that produces a different answer, for instance by locating an SMF role with someone who is junior to an individual who is not an SMF (that is, effectively delegating it) is unlikely to survive scrutiny and so should be treated very warily.

A good test of responsibility is to "stress test" a conduct failure to identify who in the organisation would be accountable for the area in which it arose and who would be responsible for resolving it. Another good test is to understand, through the firm's performance framework and reward mechanisms, who takes credit for achievements within those areas.

ii. Allocating Prescribed Responsibilities

The concept of Prescribed Responsibilities is new and is intended to ensure that certain responsibilities the regulator wants to cement into firms' structures are suitably covered[15]. There are seven Prescribed Responsibilities that apply to both Core and Enhanced firms. These include the firms' compliance with the SM&CR itself, as well as with CASS and financial crime. There are also an additional seven that only apply to Enhanced firms, covering matters such as the Responsibilities Map and the independence and performance of Internal Audit and Compliance (see Table 5).

[15]Branches and firms in the Limited regime are not subject to Prescribed Responsibilities

Table 5: Prescribed Responsibilities applicable to different SM&CR regimes

		Core	Enhanced
1	Performance by the firm of its obligations under the Senior Managers Regime, including implementation and oversight	✓	✓
2	Performance by the firm of its obligations under the Certification Regime	✓	✓
3	Performance by the firm of its obligations in respect of notifications and traning of the Conduct Rules	✓	✓
4	Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime	✓	✓
5	Responsibility for the firm's compliance with CASS (if applicable)	✓	✓
6	Responsibility for ensuring the giverning body is informed of its legal and regulatory obligations	✓	
7	Responsibility for an AFM's value for money assessments, independent director representation and acting in investor's best interests **(AFMs only)**	✓	✓
8	Compliance with the rules relating to the firm's Responsibilities Map		✓
9	Safeguarding and overseeing the independence and performance of the internal audit function (in accordance with SYSC 6.1)		✓
10	Safeguarding and overseeing the independence and performance of the compliance function (in accordance with SYSC 6.2)		✓
11	Safeguarding and overseeing the independence and performance of the risk function (in accordance with SYSC 7.1.21R and SYSC 7.1.22R)		✓
12	If the firm outsources its internal audti function, taking reasonable steps to ensure that every person involved in the performance of the service is independent from the persons who perform external audit, including: • supervision and management of the work outsourced internal auditors • management of potential conflicts of interest between the provision of external audit and internal audit services		✓
13	Developing and maintaining the firm's business model		✓
14	Managing the firm's internal stress-tests and ensuring the accuracy and timeliness of information provided to the FCA for the purposes of stress-testing		✓
	Overall responsibility		✓

Prescribed Responsibilities should be located with the SMF who is "the most senior person responsible for that issue." You will need to consider carefully what this means for your firm. Several of the Core Prescribed Responsibilities are cross-organisational, so unless they are allocated to the chief executive this may require an element of matrix reporting between peers that may be new to you and have follow-on implications for the way your firm operates. There are also some specific restrictions and guidance on how to allocate these, and it is worth taking some time to think through whether these have any consequences for your implementation.

All Prescribed Responsibilities must be assigned to an SMF, so that if there is only one SMF in your firm, that person must be allocated all of them. It is possible to share or divide Prescribed Responsibilities but the consultation paper is clear that the FCA would strongly prefer these were each held only by a single individual. If you do decide to share or divide one of them, your firm will need to "show why this is justified and confirm that this does not leave a gap."

iii. Drawing up Statements of Responsibility

Every Senior Manager will need to have a Statement of Responsibilities (SoR), setting out his or her role and responsibilities, including any Prescribed Responsibilities held. This is submitted to the regulator and must be updated with any significant changes. These will need to be clear and tightly worded, with no overlap between different SMFs.

The process of compiling SoRs is likely to expose a series of dormant issues within many firms. These may take a number of forms, including the following:

- Areas where the SMF has responsibility but not the authority to fulfil it
- Responsibilities that are divided and a material change in reporting lines is needed to locate them in a single SMF
- The responsibility for an area currently sits with a relatively junior member of staff, and a decision needs to be made whether to promote the person concerned, or move the responsibility to a more senior person
- Several responsibilities are currently vested in committees rather than individuals and the Chairs of these are not the most relevant SMFs

Core and Enhanced firms may also come across problems that are essentially two sides of the same coin. Core firms may find that sticking to the stipulated number of SMFs leaves significant gaps across the firm where the manager of an area is not an SMF, leaving regulatory responsibility concentrated unevenly in a small number of individuals. Enhanced firms may also discover uncomfortably large gaps, this time in the required coverage of their SMFs, meaning that if their Responsibilities Maps are to cover all their activities, those in SMF18 (Other Overall Responsibility) positions will be numerous.

The other factor to remember when composing SoRs is that they are tailored to the role not the individual (that is, the contents apply equally should the incumbent move on and be replaced). This is likely to be a particular issue as the current generation of SMF holders moves on and is replaced. In many cases, the roles and suite of responsibilities will have grown incrementally over time, shaped by individual skills and preferences as well as by the firm's needs at that time.

These are perennial issues, especially in senior roles, but the requirement to establish SoRs is likely to accentuate them. The problem is also likely to be more material for Enhanced firms because they need to have all their activities covered. We would therefore recommend you consider how the SoR for each SMF would look generically (that is, discounting the specific skills and history of the present incumbent). If the result is significantly different, then it would be worth planning ahead how you want to deal with the difference, either in the run-up to or at the point of succession. This will be especially relevant for Enhanced firms, which are required to have Handover procedures for SMFs (see below).

SoRs will need to be signed up to by the individuals concerned, prior to submission to the FCA. In the run-up to the implementation of the SM&CR for banks, there were concerns that individuals would refuse to do so, or seek to renegotiate employment contracts or terms. This fear seems to have been largely unfounded, with most Senior Managers accepting the need for SoRs, both as a tool for clarifying their accountability and as a necessary feature of working in the industry.

An ongoing task for the firm is the maintenance of the SoRs. This will need to keep up to date with organisational changes that realign responsibilities, and will also need to act as an audit trail so that the firm and/or regulator can go back to a point in time should the need arise and identify how accountabilities were assigned at that time. This will need to be a precise and reliable process and you will need to consider whether your existing procedures are sufficient or if you will need to establish a fresh record keeping arrangement.

iv. Preparing and maintaining a Responsibilities Map (and Handover procedures): Enhanced Regime only

Having to draw up and maintain a Responsibilities Map for your firm, although not the most headline-grabbing aspect of the SM&CR, is arguably the requirement that will have the greatest single impact on how your firm operates. It only applies to Enhanced firms but, among its other effects, it will change the focus of their relationship with the regulator. The wider question is whether the culture it produces – at the regulator as well as in the firms affected – will trickle down and permeate relationships and expectation for firms in the Core regime.

The conceptual shift embodied in the requirement to produce a Responsibilities Map, is the move away from looking at an identified number of key roles (SMFs) within a firm to starting with the firm and its activities and dividing them up between SMFs. It means that all the firm's activities are covered by the regime, with no gaps. This has a number of significant consequences, in particular the following:

- All incidents of misconduct will be traceable back to a single SMF
- Every internal restructuring a firm does will create a ripple in its regulatory relationship and require its Responsibilities Map to be updated
- Discussions about regulation within these firms are likely, as a result, to command much wider interest and they are likely to establish Regulatory Affairs functions if they have not already, or expand them if they have

The FCA is classically neutral in its attitude towards what Responsibility Maps should look like. They are undoubtedly right to be so, but in the short term, as firms design and test them, it will increase the uncertainty. The test the FCA sets – "*would your map adequately explain your firm to someone who didn't work for you?*" – is a reasonable one but still leaves a substantial grey area for interpretation. At this early stage, our advice would be to start from a map that is recognisable to someone who does work for you, and only then consider how easily an outsider would understand it. However, SYSC 4.5 sets out the FCA's expectations.

Table 6: Potential elements of a responsibilities map (SYSC 4.5)

- The names of all the firm's SMFs, members of its governing body and (if different) management body who are not approved persons, senior management and senior personnel
- Details of the responsibilities which they hold, described in any current statement of responsibilities, including prescribed responsibilities
- Rationale (if applicable) in allocating any prescribed responsibility to more than one person jointly; or dividing a prescribed responsibility between individuals
- Details about the allocation of overall responsibility for a firm's activities, business areas and management functions, including:
  - what those activities, business areas and management functions are
  - the management and governance arrangements relating to them
  - details about whether and how they are shared or divided up (and the reasons for doing this)
  - the identity of the persons to whom those functions are allocated
- Matters reserved to the governing body (including the terms of reference of its committees) and, if different, the management body. This includes details of how the firm's management and governance arrangements fit together with its group and any member of its group
- Information about the persons described or identified in the management responsibilities map, including:
  - whether they are employees of the firm and, if not, by whom they are employed
  - if they are certification employees of the firm
  - the responsibilities they have in relation to other group members
- Details of how the above fit together and fit into the firm's management and governance arrangements as a whole.

Handover procedures (enhanced firms only)

Proposing to introduce a requirement to have Handover procedures in place for SMFs in Enhanced firms is perhaps the oddest section of the consultation paper. On the one hand, this obviously meets the threshold test of something that any well-run firm would be doing anyway, in which case it is hard to see the driver for needing to enshrine it in regulation. On the other, however, if handover procedures are as important as it seems here, it is hard to see what the virtue is of confining it to the Enhanced regime.

Handover procedures will need to make sure that people who are becoming Senior Managers have all the information and material that they could reasonably expect in order to do their job. This places an onus on outgoing SMF holders and the firm to provide an up-to-date summary of the situation in the relevant area(s) of responsibility. The handover pack will also act as a record of an outgoing SMF's declaration of the state-of-play which, if found to be lacking, will be held up as evidence.

Our advice at this stage would therefore be for firms in the Core regime also to make sure they have recognisable and clear handover procedures for their SMFs. This will minimise the chances of being caught by regulatory creep. Future supervisory visits, if they identify the absence of these, and particularly if there has been a conduct failure, will likely find it very difficult not to criticise. Having Handover procedures for senior roles is simply good business practice.

Duty of Responsibility and "Reasonable steps"

This is where the Senior Manager regime intersects with the Enforcement process in the shape of DEPP[16], which sets out the criteria for using enforcement powers. The logic of this, given the intended increased accountability of individuals that is the main driver of the SM&CR, is that SMF holders will need to take greater care in documenting their actions and the reasoning behind them.

Providing support for SMFs, to enable this documentation to occur will therefore need to become a priority for firms. The alternative is likely to be that it will become more difficult, especially once the current generation of SMFs moves on, to find talented individuals prepared to take up these roles. This is likely to be further highlighted when the FCA starts taking Enforcement action under the SM&CR and the definition of what is judged "reasonable steps" – likely to be a high bar – becomes clearer.

There are a number of potential dangers (unintended consequences) in the Duty of Responsibility and the idea of "reasonable steps" that your firm should consider carefully and, if necessary, take steps to avoid. These are four of the most important:

- The importance, particularly when dealing with a (potential) conduct failure, for each SMF of keeping other SMFs with a relevant interest informed of your actions and the reasons for them, and where possible giving them the chance to offer comment or advice.
- As a reflection of this, your firm's culture should take care to encourage relevant SMFs to offer help and advice to each other. One of the risks of a doctrine of individual accountability is that it may in some circumstances incentivise SMFs to steer clear of involvement in (potential) conduct failures where they do not have direct responsibility. This is a high risk as poor communication across silos has a history of causing and/or exacerbating failures.

[16]Decision and Procedures and Penalties Manual

- Almost without exception, conduct failures have their roots long before the event occurs. Consequently, being able to demonstrate that different options are routinely considered and risks are sensibly identified and managed is important all year round, not only when there is a crisis. Whatever the level of support you decide to provide to SMFs should therefore be permanent and built into your firm's operating model and budget.
- Perhaps counter-intuitively, committees can be one of the weak points in this area. Often it is challenging to document options and reasoning effectively and the instinct of many Chairs and Secretariats is to go straight to recording decisions and action points. An increased emphasis on the Chair's discretion may accentuate this approach, but it is unlikely to be enough to demonstrate "reasonable steps" in what will often be fast-moving and finely-balanced situations.

These are not hypothetical problems, they recur frequently – for both firms and regulators – through the various reports on regulatory failures over the past 25 years, from the Bingham Report on BCCI in 1992 through to the Davis Review of the press briefing ahead of the FCA's 2014/15 Business Plan.

Finally, your firm should be prepared for a trade-off between being able to demonstrate that SMFs have taken "reasonable steps" and their speed of action, even in a crisis. This may well be an advantage overall but it is likely to have a short-term cost that you will need to factor into your planning.

6. Certification Regime

Introduction

One of the headlines of the SM&CR is that the Senior Manager regime has a much tighter, more senior coverage than the APER it replaces. However, the bigger picture is that the complementary Certification regime not only picks up the remaining positions currently covered by the APER but also captures a wide range of other staff. Due to the requirements of the legislation, this applies to Core and Limited as well as Enhanced firms and is the most onerous "one size fits all" aspect of the FCA's proposals.

Table 7 (below) shows the functions covered. Two of the most notable additions beyond the APER are the extension of the client dealing function, beyond the current CF30, to include all those dealing with clients (that is, from retail through to eligible counterparties) and the inclusion, except for Insurance firms, of "Material Risk Takers" (that is, staff covered by the Remuneration Code).

Table 7: Certification Functions

Certification Function	Approved Person or equivalent	Overview
Significant Management Function	CF29	These certification functions approximately equate to the Significant influence Function" under the existing Approved Person regime. [Note that these roles are different from the Group Entity roles covered by SMF7]
Proprietary Traders	CF29	
CASS oversight	CF10a	
Functions subject to qualifications	Various	Only relevant to Firms with employees currently covered by the Training and Competence rules. Roles including but not limited to: • mortgage advisers • retail investment advisers • pension transfer specialists.
Client dealing function	CF30	This function will include, and expand on, the existing CF30 customer function in the Approved Person regime. It includes any person dealing with clients including retail and professional clients and eligible counterparties.
Supervisor or manager of a certified function (but not a senior manager)	Various	This function ensures there is a clear chain of accountability from more junior certified staff and the Senior Manager Function responsible for that area. There can be no 'gaps' in the reporting chain up from a certified person, all staff in that chain must be certified until the SMF holder is reached.
Material risk takers	Remuneration code staff	All firms under AIFMD, UCITS, IFPRU and BIPRU are already required to identify material risk takers as part of a firm's SYSC 19 requirements. Firms need to identify material risk takers across ALL risk types (market, credit, liquidity, operational) and include them as certified persons.
Algorithmic traders	N/a	Includes people responsible for: • approving deployment of a trading algorithm • approving deployment of a material change to a trading algorithm • monitoring or deciding whether or not the use or deployment of a trading algorithm is or remains compliant.

The legislation defines certification functions as those that, while not SMFs, require "the person… to be involved in one or more aspects of the firm's affairs… (that) involve, or might involve, a risk of significant harm to the firm or any of its customers." Although many of the people caught by this definition will already be Approved Persons, assessed as fit and proper by the FCA, it would be a mistake to underestimate how many staff may be covered for the first time.

The big shift, of course, is that the Certification regime places the onus for approving and annually assessing affected staff wholly on the firm, whereas the regulator was responsible under the APER. As a result, the FCA will no longer be responsible for assessing whether these individuals are fit and proper. This is more complex than it seems at first sight.

On one level, the regulator is "outsourcing" significant parts of functions it has been performing itself, but it is reasonable for the regulator to argue that it makes sense for direct regulation, under the Senior Manager regime, to be more tightly focused. Conversely, as described below, the regulator is prescribing in considerable detail how certification should operate. This brings the strengths of consistency and predictability to the regime but in the process it sacrifices a significant degree of proportionality in its application to smaller firms.

Identification of Certification regime population

Correctly identifying a firm's certified population is obviously a critical factor in successful implementation. There are clear temptations both to certify the smallest number of people your firm considers necessary so as to minimise compliance costs and, on the other hand, to attempt to cover yourself by certifying all individuals who you believe may be covered.

In the longer term, however, neither of these approaches is likely to work well. The FCA, at some stage, is likely to take a negative view of the minimalist approach, while the more defensive approach is likely to mushroom over time to include an ever larger population and have a material compliance cost for the firm, particularly when the full implications of the regime are factored in. it may also have a damaging effect on your firm's culture by unnecessarily making people feel vulnerable to direct regulatory action.

Instead, we would recommend taking a little more time at the start to understand how the Certification regime fits with your firm's structure and consider if there are any anomalies you would prefer to remove, either immediately or as individuals move on. You should understand the areas where the regime's application is straightforward, as well as anywhere it needs to be more tailored to your business model. Being able to explain this distinction and use it consistently over time will put an effective limit on your compliance costs, as well as enabling you to explain your approach credibly to both the regulator and your own staff.

Areas for specific consideration

In its consultation, the FCA draws attention to some specific areas. Some of these are potentially grey, where a given role is likely to be an SMF in Enhanced firms but a Certification function in Core. We would recommend your firm considers the following;

Significant Management Certification function

This applies to people with "significant responsibility in a significant business unit", who would have been in significant influence functions (SIFs) under the APER. For medium-sized firms, there will be a choice with some of these roles, between leaving them as certified and deciding that they are effectively SMFs. As elsewhere, it will be important that your firm makes such decisions based on its own business model rather than creating (or perpetuating) a mismatch of responsibility (and authority) that may cause issues later.

The consultation sets out a number of factors, taken from its Handbook, to help identify whether a business unit is "significant", several of which are related to each other. These do not include any quantification but, with some added interpretation, are helpful nonetheless. They are as follows:

- **The risk profile of the unit:** Because the FCA explicitly says such business units can include internal support departments such as information technology and human resources, this assessment should include operational as well as other types of risk. To state the obvious, the assessment should also draw heavily on your firm's risk map.
- **The unit's use of the firm's capital:** Given the intent of much capital regulation, this is in effect another measure of a unit's risk profile. The regulator is therefore likely to use this partly as a check on any risk assessment you have made separately.
- **Its contribution to the profit and loss account:** In the past, most notoriously with Barings in the early 1990s and with PPI in the mid-2000s, the regulator has missed the fact that ostensibly small and low risk units were contributing vastly disproportionate sums to a firm's P&L. This factor is a reminder to both firms and regulators not to fall into this trap again.
- **The number of employees, Certification Functions or Senior Managers in the unit:** This is a common sense check, for if there are certification staff anywhere within a unit, the head of that unit should be at least a Certification function itself. Similarly, if there is an SMF in a unit then the head of that unit would also need to be an SMF. The regulator is likely to use the employee test both in absolute and in relative terms (that is, compared to other units whose heads are certified).
- **The number of customers in the unit:** Again the regulator will use this as both an absolute and a relative test, as well as a crude measure of risk. The type of customer and adjudged level of vulnerability will also come into play.
- **For branches of non-UK firms, the size and significance of the firm's business in the UK**: There are only a small number of SMFs required for a branch, even fewer for an EU branch. One way of viewing this is as a mechanism, should the large branches decide not to have a larger number of SMFs, for using the certification regime to expand the net of accountability.

In its consultation, the FCA uses the specific example of a collections unit in a lending firm and we would also expect the following "Heads" to be Significant Management Certification Function:

- Head of Complaints handling
- Head of Underwriting
- Head of Investment Platforms
- Head of Personal Lending

Depending on the size of your firm and your business model, you might consider whether any of these functional roles are sufficiently large to be SMFs. If so, the obvious route would be to use SMF3 (Executive Director), which is a required SMF for Core firms where the role exists, though this might require you to amend your existing management structure.

Overlap with Senior Manager Regime

In the consultation, the FCA asks if there are any of the Enhanced SMFs that should be considered for the Core requirements. The honest, but possibly unhelpful, reply might be that it depends on the firm and the responsibilities of particular roles. The best way of dealing with this is probably for the FCA to be more explicit about Core firms being able to add SMFs that reflect their business models without being required to take on the additional requirements that would come with these in the Enhanced regime.

Broadly, there are three sorts of Enhanced SMFs that might make sense for some Core firms to use:

- **Roles that reflect your culture:** Most likely, these would be COO, or one or more of the control functions (Finance, Risk, Internal Audit). In the latter case, unless you elevate all three, you will need to think about the relationship with Core SMF16 (Compliance Oversight).
- **Roles that reflect your structure:** Logically, SMF7 (Group Entity Senior Manager) is not a function of size and so should not be restricted to Enhanced firms. If your firm, as a UK-regulated entity, is part of a larger group then there may well be someone with "significant influence on the management or culture" of your firm who is employed elsewhere in the Group.
- **Roles that reduce operational risk:** There are a number of the Enhanced SMF roles that might perform this function, including the Board roles. However, the most obvious role to use as a mitigation against operational risk is SMF18 (Other Overall Responsibility). Depending on your firm's business model, this could be used in various ways, but in particular to:
  - Reduce pressure on other roles carrying broad regulatory responsibility, typically the chief executive (SMF1) or Compliance Oversight (SMF16).
  - Improve the consistency of your approach to regulation, particularly if your firm has a tendency to operate in silos or is relatively decentralised.

On the face of it, suggesting Core firms consider additional SMFs may be counter-intuitive given the increased burden the Certification regime will bring. However, the real risk, in terms of both costs and compliance, is of implementing it in a way that does not reflect your firm's business model. Instead, by understanding the implications of the SM&CR as a whole, it should be possible to implement it in a way that goes with the grain of your firm's business model and culture.

Specific considerations

i. Overseas employees

The Certification Regime is generally limited, for UK firms, to people based in the UK. This is the territorial limitation. There are three exceptions to this:

- Material risk takers (except for Insurance firms)
- Those performing any other "Significant Harm" function
- Those dealing directly with UK clients

The FCA has acknowledged the difficulties firms may have in applying the territorial limitation, particularly for complex global organisations such as asset managers.

ii. CASS oversight function

CASS, rightly, is one of the most heavily regulated areas of financial services and this is reflected in the SM&CR, where CASS Compliance is a Prescribed Responsibility that must be allocated to an SMF. And CASS Oversight is a Certification Function that can either be allocated to the same SMF, or, if the role is more operational, can be kept separate.

The right answer for your firm will depend on the significance of CASS to your business model and, potentially, on the complexity of your Group structure and the number of UK-regulated entities holding client assets. Depending on size of your firm and its business model, therefore, you may want to combine, split or multiply[17] these two roles

[17]For example, in a Group where more than one entity holds significant client assets, you might choose either to have a separate SMF and Certification function in each entity or, at the other end of the spectrum, to focus both roles across the group in an SMF7 (Group Entity Senior Manager).

iii. Client-dealing function

As mentioned above, the Client-dealing Function extends the scope of the existing CF30 role. This is the group where the territorial nature of the Certification regime is most likely to spread overseas. It is broadly framed and, as well as applying to all types of customers, covers a wide range of roles:

- Advice on investments, including dealing and arranging
- Dealing or arranging deals in investments, as principal or agent
- Acting in the capacity of investment manager, and connected functions
- Acting as a bidder's representative

We have already noted that the FCA acknowledges the complexity of the situation this will create for some firms and has asked for feedback. However, having set out its stall as broadly as it has, it presumably believes the cost benefit analysis stacks up and so is unlikely to be persuaded against the substance of its proposals.

The certification process

For many firms, the process around implementing the Certification regime will be the most onerous part of the SM&CR, in terms of both time and cost. It also has potential to alter the relationships between staff and their management and between staff and the human resources function.

The regime encompasses a number of tasks, which can broadly be divided into three groups:

- **Those needed to set up the regime:** These include identifying people employed in Certification roles, assessing whether they are fit and proper for those roles and issuing them with a certificate covering the activities of the firm in which they are involved.

- **Maintenance tasks:** These include assessing at least every 12 months whether a person is fit and proper and issuing a new certificate accordingly. For many firms, this will have implications for their annual appraisal process.

- **Dealing with events:** these include individuals moving jobs, emergency appointments, the firm deciding an individual is not fit and proper, and investigations after conduct failures (either by the firm or the regulator, possibly via an s166 Skilled Person review).

There are a number of detailed and important aspects to this process that warrant a fuller treatment. Some of this is provided below, however your firm will need to examine the FCA's proposals and the final requirements closely, map out their impact on your business model and then think through carefully what choices will serve you best over the short, medium and long term.

Performance management

The importance of a firm's performance management arrangements becomes significantly greater under the Certification regime. Firms that have successfully implemented the regime in the first wave of rollout have:

- Embedded the Certification regime into already well established performance management frameworks

- Systematised the administrative elements of the process

- Ensured systems (existing or newly implemented) were able to capture all relevant information and data on an on-going basis to use for annual certification

- Developed systems to ensure adequate record keeping and management information can be produced on the firm's certified population

Equally important to on-going annual certification is ensuring new hires are certified when joining, and so will almost certainly increase the due diligence a firm carries out during the hiring process. At the point of on-boarding a new hire, the certification assessment should take into account, in addition to the usual elements, regulatory references from previous employers.

7. Fit and proper requirements

Introduction

Firms will need to apply the fit and proper test to all holders of SMFs and Certification functions, and to any non-executive directors who are not SMFs. The assessment should be on a continuing basis and will need to be formalised at least annually.

The FCA proposes using the existing requirements for the fit and proper assessment. These are detailed in current FCA rules, but should cover at least the following areas:

- Whether that person has obtained a required/relevant qualification
- The on-going training records of that person
- The competence of that person to perform that role
- The personal characteristics of that person

If a person carries out more than one Certification function, which is allowed under the proposed rules, then your firm will need to certify that he or she is fit and proper to perform each function. While each function must be assessed, it can be completed in one certification process and only one certificate needs to be issued.

Criminal records checks

Under the APER, candidates for Approved Person roles are required to disclose if they have a criminal record, but the SM&CR proposes extending this so that firms will need to conduct a check as part of each SMF application. This would also apply to overseas jurisdictions where an individual has spent a significant period outside the UK.

These checks are not mandatory for Certification functions but the FCA leaves it open to firms to choose to extend it themselves.

Regulatory references

These proposals would require firms hiring people who have held SMF or Certification functions, or been a non-executive director at UK-regulated entities, to request a reference from their previous employers going back six years. There will be a standard template and the proposals would create an open network of information exchange between all UK-regulated firms around a common set of disclosures.

The main burden on firms will be the systems they need to establish to create and maintain these records, which, for example, will need to cover any disciplinary action or upheld complaints. The proposals would also preclude firms entering any arrangements with an employee / former employee that conflict with these disclosure obligations.

There may be a series of unintended consequences as a result of these provisions, as firms' procedures are forced to become more formal to comply with the disclosure requirements, and staff increasingly challenge management judgements that may damage their future careers. There is also a possibility that the heightened pressure around disciplinary action will deter them being taken. Firms will need to consider, and then monitor carefully, what impact the new requirements will have on their people management and culture generally.

8. Conduct rules

Introduction

One of the outgoing parts of the APER is the Statements of Principle set out in APER 2.1A. These apply only to approved persons and require that they must:

- Act with integrity
- Act with due skill, care and diligence
- Observe proper standards of market conduct
- Deal with the regulator in an open and cooperative way and disclose appropriately any information of which the regulator would expect notice

Some of the regulatory enforcement actions taken against individual approved persons over the years have turned on whether the individual in question met the behaviours set out in these Principles.

The SM&CR replaces the Statement of Principles with a set of Conduct Rules that will be applicable to staff well beyond senior management (that is, those who were previously Approved Persons). They will apply to the great majority of staff in every regulated firm, giving the FCA the power to take enforcement action against them, greatly expanding its ability to reach deep into a firm.

What are the Conduct Rules

There will be two tiers of Conduct Rules, and these will apply to all firms. The First Tier (individual) rules (Table 8), which follow closely the old Statements of Principle, applies to all relevant employees. The Second Tier (Senior Manager) rules (Table 9) are additional and will apply only to SMF role holders.

Table 8: First Tier – Individual Conduct Rules

Rule		Comments
1	You must act with integrity	This is the expectation that individuals will deal honestly with their colleagues, with customers and with the regulator.
2	You must act with due care, skill and diligence	This is the expectation that individuals will act with the skill and care that would be reasonably expected of a competent individual performing the role which they are engaged to deliver.
3	You must be open and cooperative with the FCA, the PRA and other regulators	This is the expectation that individuals will respond fully and honestly to any enquiries made of them by regulators.
4	You must pay due regard to the interests of customers and treat them fairly	This Rule exceeds the outgoing Statements of Principle and creates an expectation that individuals will treat customers fairly and act in their interests. This essentially hard bakes "Treating Customers Fairly" principles into individual accountabilities and enables the FCA to take action against any individual who does not meet this expectation.
5	You must observe proper standards of market conduct	This is the expectation that individuals will follow the rules and standards of the markets in which they operate. In particular, that individuals will not try to manipulate these markets to achieve an advantage.

Table 9: Second Tier – Senior Manager Conduct Rules

Rule		Comments
SC1	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively	These Conduct Rules make up a collective obligation to take reasonable steps to control the business, ensure it is compliant and that responsibilities which are delegated are subject to proper oversight. This represents a new, and higher, duty of care; we explore its implications later in this chapter.
SC2	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system	
SC3	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively	
SC4	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice	This expectation goes beyond the first tier rule, requiring individuals to deal openly and honestly with the regulator, by imposing a positive expectation on SMFs that they will proactively notify the regulator of significant matters. That same obligation already exists on the firm (principle 11 of the Principles for Business) but has not previously been a specific individual accountability. We explore the new requirement later in this chapter.

Individual Conduct Rules

i. Who they cover

As well as SMFs and Certified staff, these will also apply to:

- Any non-executive director who is not in an SMF role. By applying the Conduct Rules to non-executive directors the FCA ensures they are covered by the new regime
- All other employees, excluding only those in “ancillary positions”

The latter is a very significant expansion of the number of financial services employees who will owe an individual obligation to the FCA. The context for this change is the desire of the regulator to raise awareness of conduct issues for those working in the industry at all levels, and it believes that requiring compliance with conduct rules will improve the awareness of these staff of the standards of behaviour expected.

The exclusion of ancillary staff is designed to keep outside the regime those individuals who do not perform a role which is relevant to the financial services nature of the wider business. Essentially this means support staff who perform generic non-financial services functions. To avoid any differences in interpretation that might arise between firms, the FCA has taken the unusual step of providing an exhaustive list of functions it considers ancillary. Firms will not be permitted to include additional roles within this definition.

Table 10: Ancillary roles exempt from Individual Conduct Rules

Receptionists	Switchboard operators	Postroom staff
Reprographics/print-room staff	Property/facilities management	Events management
Security guards	Invoice processing	Audio-visual technicians
Vending machine staff	Medical staff	Archive records management
Drivers	Corporate Social Responsibility staff	Data controllers and processors under the Data Protection Act
Cleaners	Catering staff	Personal assistants and secretaries
Information Technology Support (for example, helpdesk)	Human Resources administrators/processors	

For the most part, the roles the FCA has set out will be relatively easy to apply. The caveat will be that where individuals perform one of these roles alongside another, non-ancillary, role they will be considered to be in scope of conduct rules.

Of the roles identified above, Information Technology Support is likely to cause the most difficulty. In this case it is important to apply the intent of the ancillary staff concept and include only those staff whose role is to keep the existing systems infrastructure operational. Information Technology staff engaged in developing systems, or in managing risks which the FCA considers important, such as information security or managing outsourced technology suppliers, should not be categorised as ancillary staff.

ii. What activities they cover

The Conduct Rules apply to individuals in respect of the financial services activities they undertake. This avoids the need to follow them for any non-financial services activity undertaken. For instance, car retailers who introduce customers to car finance or insurance would have them apply only to their car finance and insurance activities not to the mainstream car sales and servicing activities they undertake.

However, while the application of conduct rules is limited only to financial services activity, this has been defined more broadly than just regulated financial services activity. So, providing loans to businesses is not a regulated financial services activity (it does not require permission from the FCA to undertake) but it is clearly still a financial service. Therefore, a firm carrying on the regulated activity of lending to individuals, would need to apply conduct rules to both its regulated and unregulated lending.

The final area where conduct rules apply, as does the APER Statement of Principles, is activities which are ancillary to providing financial services. Hence many activities of a firm will be covered if they support the provision of financial services in some way. A Treasury function, which manages the firm's cash flow, or its Risk or Internal Audit functions – themselves not regulated activities – are clearly ancillary to the general business of the firm, which is financial services.

Senior Manager Conduct Rules

i. SMFs and the reasonable steps obligation

The SM&CR Second Tier rules introduce three obligations to take "reasonable steps":

- To ensure the business of the firm for which you are responsible is controlled effectively (SC1)
- To ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system (SC2)
- To ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively (SC3).

These requirements should be seen as an expansion on the APER Statement of Principle to act with due care, skill and diligence, which survives in the First Tier. It is an important change in the duty of care owed by individuals who will become SMFs. The change works in three ways:

- It makes it very clear that the individual duty extends to control of the business and its regulatory compliance
- The prescription on delegation prevents SMFs from arguing, or attempting to argue, that they do not bear responsibility for the acts of their delegates
- It changes the test of competence from the familiar norm of English civil law – that of a reasonable person performing the same role – to one which gives the FCA discretion to imply its own standards on what constitutes reasonable steps.

ii. Applying reasonable steps in practice

A note of caution is necessary here. We can expect our understanding of what constitutes reasonable steps to develop over time as we see how the FCA takes action against individual SMFs under the SM&CR. Our current knowledge base is drawn from cases which the FCA has bought under the APER, and we can expect, over time, to see new decisions which clarify what it judges to be reasonable steps across a range of situations. Reasonable steps compliance by any SMF will therefore require continuing review of what the FCA says on the subject. What we do know about implementing reasonable steps is set out in table 11.

Table 11: Current understanding of what constitutes "reasonable steps"

1	The accountabilities set out in the individual SMF's Statement of Responsibilities are the critical starting point. These are the accountabilities for which reasonable steps must be taken. Prepare a matrix to list the reasonable steps that are being taken for each accountability.
2	For most SMFs there are broadly two different dimensions to each accountability they hold: • The responsibility to oversee the continued performance of that accountability ('business as usual') • The responsibility to make changes and decisions that affect that accountability. Applying these to a real life example, an SMF may be accountable for lending approvals in a personal finance business. His or her accountability extends both to making sure the business as usual runs smoothly and to making decisions on changes in how that business operates, for instance changes in process or decision-making criteria. The reasonable steps matrix should reflect two columns, one for business as usual steps and one for change/decision-making steps.
3	Populate a list of the actions that are taken to ensure business as usual operates effectively (that is, in a controlled way which is compliant with regulation). Strong contenders for this list include: • Setting clear objectives for the activity, including risk limits • Periodic review and sign off on the procedures which apply to that activity • Periodic review and sign off on the training and competence regime which applies to staff working in that activity • Regular review of risk registers and control events/failures that are identified. It is essential that SMFs are seen to use and react to this information, taking follow-up steps to understand issues and take corrective action. Simply receiving this information, and not responding to the "red flags" within it, will not meet the expectation for reasonable steps • Management information (MI) received and reviewed. This raises the crucial question of whether MI produced is informative, and covers the full range of activities for which the SMF is accountable. One of the major areas in which banks have developed under SMR is in the way that MI has had to be re-cast or enhanced to provide a good alignment to SMF accountabilities. As above, it is not enough for SMFs to receive MI, they will need to be able to show they reacted to it and took the issues it may indicate seriously • Oversight and challenge by a committee looking at some or all of the activities for which the SMF is accountable.
4	Populate a list of the actions that are taken to ensure change and decision making is conducted effectively. Strong contenders for this list include: • Standard procedures in place for authorising changes to business process • Standard procedures in place for changing risk limits • Oversight and challenge by a committee looking at some or all of the activities for which the SMF is accountable. SMFs will not be able to delegate their accountability to a committee, however they can use a committee to demonstrate they took reasonable steps to consult and understand the full range of issues and viewpoints with regard to an activity • Minuting disciplines for decisions. These should include recording what information was presented to support the decisions, what risks were considered that might cause the decision to fail to have the intended result (or unintended consequences) and any conditions or limitations that applied to the final decision (for instance anything which had to take place as a condition for the decision to take effect).
5	Delegation could appear in either of the lists above covering reasonable steps. It is not unusual for accountable SMFs to set an objective for another individual to provide a level of supervision to one or more of their accountabilities. This is particularly true where SMFs have a significant span of control and limited time to review any given area, often restricted to receiving MI and dealing with issues or key decisions. Beyond these there may be limited practical involvement. In such cases a delegate may be relied upon subject to the following: • The skills and experience needed to act as a delegate are documented by the SMF. If delegates do not meet the required level, extra training or support takes place to build up their knowledge, with greater supervision from the SMF while that is happening • Decision-making authority and limits are clearly defined for the delegate • Formal (documented) review meetings take place between the SMF and the delegates when their sphere of accountability is discussed. It is difficult to imagine these could be less frequent than monthly while still meeting expectations on ongoing supervision • Performance rewards for the delegate are appropriately aligned to the control and regulatory compliance elements of the SMF's accountability. SMFs who permit their delegate to participate in an incentive scheme which might lead him or her to de-emphasise control and compliance are unlikely to have acted reasonably.

We expect many firms will develop and implement "Reasonable Steps" policies which set out what they require SMFs to follow in the areas described in table 11. This will address the potential for wide variations in practice between SMFs in the same organisation, as inevitably there is a component of personal risk appetite for SMFs deciding whether they have done enough. Certain SMFs might adopt a more hands off approach than is justified, and a firm level policy on the subject should help minimise this issue.

iii. Individual responsibility versus duty of the firm

An interesting dynamic which we see as inevitable under the SM&CR, is the tension between SMFs and the firm in terms of responsibility for providing the tools to execute SMF duties. The SM&CR is geared toward individual responsibility, but an individual could argue that the firm has not provided the tools to discharge that responsibility. The regulator's view here is largely untested. However, we can infer from other instances that the FCA (where we have some read-across) expects an SMF to be senior enough to force the firm to provide the necessary support. If they are, in practice, not influential enough to get the support they believe they need, then they are unlikely to be viewed sympathetically by the regulator when something does go wrong.

This is one facet of the "duty of responsibility" doctrine embedded in the regime. All SMFs are required to demonstrate that they take "reasonable steps" to ensure the sound running of their part of the business. In the above example, the SMF would be expected to show evidence that he or she had raised concerns about the shortcomings (for example, a staff shortage in credit risk) at a sufficiently elevated level, and in a sufficiently clear way. This requirement becomes all the more important for the SMF should something go wrong "on their watch".

SMFs and the obligation to notify the regulator

There is also a Senior Manager Conduct Rule which requires SMFs to disclose appropriately any information of which the regulator would reasonably expect notice. This essentially takes the existing requirement which applies at the firm level (principle 11 of the Principles for Business) and makes it a personal obligation on individual SMFs.

There have been instances where the FCA has taken action against a firm where it has felt there was an issue or event which it would expect to have been made aware of but which the firm did not disclose until later, or not at all. Based on the content of those actions, we can see that the FCA considers the failure to notify it to be one of the most significant failings which can arise. Under the SM&CR the regulator could take the same action against individual SMFs as against firms.

The Principle 11 obligation has been in existence for many years (supported by more detail and guidance in SUP 15.3 and SUP 15.7) and most organisations have some sense of what events might merit a notification. Typically, this follows some degree of investigation to gauge the scale of an issue. However, your firm should not delay notifying because there is not complete certainty on the scale of an issue, although it appears likely to be large.

What does change is that the obligation to notify expands from being the firm's, usually opined on by the Head of Compliance or General Counsel, and also becomes the individual responsibility of the relevant SMF(s). We expect that much the same procedures and discussions as take place in respect of Principle 11 notifications will continue to take place for notifications going forward. We do not expect, and the rules do not intend, that SMFs should notify the regulator without first discussing the matter and the notification internally. However, the personal risk assessment of SMFs now also come into play if they find themselves in disagreement with the firm on whether the matter merits notification. Ultimately, if the SMF believes it would be prudent to notify the regulator of an issue then notification should take place, and we would expect a firm's policies to provide SMFs with clear authority and support to make that decision.

To meet this obligation effectively, it will be necessary in most cases for SMFs to receive much more specific training than is normally the case today, covering when and why notifications should be made. It is not appropriate for SMFs to rely on other people to tell them when a notification is required; they will need to be able to make that judgement for themselves.

The firm's obligation to its staff

SM&CR will impose a training and notification obligation on all firms. This requires the firm to:

- Notify all staff who are subject to the Conduct Rules that this is the case, and train them on their application
- Notify the FCA when formal disciplinary action is taken against any member of staff in which his or her breach of a Conduct Rule is an element of the action. A form will be provided by the FCA for this purpose and notification is required within seven days of the disciplinary action commencing.

As a result, firms will need to instigate a training programme for all staff impacted, informing them of their obligations at least annually. We expect this training to be relatively generic in many cases, but it is important to include examples which are relevant to the firm and to many of its staff. In this respect, it is similar to other large-scale regulatory training undertaken by the firm, for instance its Anti-Money Laundering training.

9. Transition arrangements

Overview

The FCA's consultation on its proposals to convert individuals from APER to the new regime closed on 21 February 2018. These proposals embody the regulator's approach to SM&CR as - "simple, clear and proportionate", by seeking to convert individuals automatically whenever possible. Only SMFs in enhanced firms will need to be formally approved.

From here, the FCA will provide feedback on the two sets of consultation, and intends to make the rules this summer. The Treasury sets the dates for the conversion to take place and we now know that, for insurance firms, this will be 10 December 2018. The FCA has also said that, for all other firms, the conversion date is likely to be mid to late 2019.

As predicted, this is after Brexit. But we would recommend firms start to assess now (if they haven't already) what impact SM&CR is likely to have on their governance and culture, how they want to manage and shape this, and what they need to do to set themselves up for long-term compliance.

Requirements at the point of conversion

At this stage, Enhanced firms should have provided a Form K and SoR for each holder of a controlled function who is being directly converted to an SMF, as well as a Responsibility Map for the firm. Ideally, the FCA will have already approved these by the conversion date. If not, there will be arrangements for in-flight applications, some of which are set out in the consultation. We expect the guidance around the various possible scenarios to expand between now and conversion.

SMFs for Core and Limited firms, which are converting directly from an existing controlled function, will be converted automatically. They will each still need to have an SoR but will not need to submit this to the FCA[19]. **Given this**, firms should consider what form of assurance they want as to whether these SoRs are appropriate and effective.

Whereas only Enhanced firms will need to submit Form K, all firms may potentially have to submit forms for individuals who either:

- do not currently hold a controlled function but will be an SMF
- do hold a controlled function but will not be an SMF
- do hold a controlled function and will transfer to a different set of accountabilities under the SM&CR.

A summary of these forms is set out below.

Summary of key forms

Form reference	Purpose
Form A	Application form used to apply for a new controlled function for an individual.
Form C	Application form used to cancel an individual approval.
Form E	Application form used to transfer an approved individual from one controlled function to another.
Form K	Used to notify conversion of mapped individuals.

*The statutory clock for these applications will technically start at the Commencement date, but we will try to process these before the start of the new regime as long as they are received in good time.

[19]The only major exception to this are non-executive directors who are Board Chairs. This is because these cannot currently be distinguished under APER but will constitute a separate SMF in the new regime.

Mapping of functions

The function mapping for Core and Limited regime firms is set out below.

Table 13: Proposed function mapping for Core and Limited firms

Current controlled function	Possible corresponding Senior Management Function(s)
CF1 – Director	SMF3 – Executive Director
CF2 – Non-Executive Director[20]	SMF9 – Chair
CF3 – Chief Executive	SMF1 – Chief Executive SMF19 – Head of Third Country Branch
CF4 – Partner	SMF3 – Executive Director[21] SMF27 – Partner
CF5 – Director of Unincorporated Association	SMF3 – Executive Director
CF6 – Small Friendly Society Function	SMF3 – Executive Director
CF8 – Apportionment and Oversight Function	SMF29 – Limited Scope[22]
CF10 – Compliance Oversight	SMF16 – Compliance Oversight
CF11 – Money Laundering Reporting Officer (MLRO)	SMF17 – Money Laundering Reporting Officer (MLRO)
CF29 – Significant Management Function[23]	SMF21 – EEA Branch Senior Management Function

[20] Non-Executive Directors at Core and Limited Scope firms who are not the firm's Chair will no longer be approved by the FCA.

[21] CF4 – Partner to SMF3 – Executive Director is only a valid conversion for EEA and non-EEA branches.

[22] This function is only applicable to Limited Scope firms that have a CF8 – Apportionment and Oversight function. Core firms should not have this function under APR but if they do, it will lapse. Firms should move the individual to a mapped function if the individual is intended to perform an SMF.

[23] This mapping only applies for EEA Branches. Individuals holding CF29 at other Core firms will not be converted to a Senior Management Function unless approved for a mapped controlled function before Commencement.

Although it is only directly applicable to Enhanced firms, the separate conversion table the FCA provides for these firms (see below) is nevertheless useful for all firms in understanding how the Regulator is approaching the new regime.

Table 14: Proposed function mapping for Enhanced firms

CF1 – Director	SMF2 – Chief Finance Officer
	SMF3 – Executive Director
	SMF4 – Chief Risk Officer
	SMF5 – Head of Internal Audit
	SMF7 – Group Entity Senior Manager
	SMF24 – Chief Operations
CF2 – Non-Executive Director	SMF9 – Chair
	SMF10 – Chair of the Risk Committee
	SMF11 – Chair of the Audit Committee
	SMF12 – Chair of the Remuneration Committee
	SMF13 – Chair of the Nomination Committee
	SMF14 – Senior Independent Director
	SMF7 – Group Entity Senior Manager
CF3 – Chief Executive	SMF1 – Chief Executive
	SMF2 – Chief Finance Officer
	SMF4 – Chief Risk Officer
	SMF5 – Head of Internal Audit
CF4 – Partner	SMF27 – Partner
	SMF2 – Chief Finance Officer
	SMF4 – Chief Risk Officer
	SMF5 – Head of Internal Audit
CF5 – Director of Unincorporated Association	SMF3 – Executive Director
	SMF2 – Chief Finance Officer
	SMF4 – Chief Risk Officer
	SMF5 – Head of Internal Audit
	SMF7 – Group Entity Senior Manager
CF6 – Small Friendly Society Function	SMF3 – Executive Director
	SMF2 – Chief Finance Officer
	SMF4 – Chief Risk Officer
	SMF5 – Head of Internal Audit
	SMF7 – Group Entity Senior Manager
CF10 – Compliance Oversight	SMF16 – Compliance Oversight
	SMF24 – Chief Operations
CF10a – CASS Operational Oversight Function[24]	SMF18 – Other Overall Responsibility
CF11 – Money Laundering Reporting Officer (MLRO)	SMF17 – Money Laundering Reporting Officer (MLRO)
CF28 – Systems and Controls Function	SMF2 – Chief Finance Officer
	SMF4 – Chief Risk Officer
	SMF5 – Head of Internal Audit
CF29 – Significant Management Function	SMF18 – Other Overall Responsibility
	SMF24 – Chief Operations

[24] If an Enhanced firm elects not to convert an individual performing a CF10a (CASS Oversight) function to SMF18 (Other Overall Responsibility) function, then this individual should be certified under the Certification Regime. The CASS prescribed responsibility should then be allocated to the Senior Manager to whom to the individual reports.

This demonstrates the way in which the FCA is individualising different accountabilities compared to APER, and should be used when thinking about drawing up SoRs. In particular, it's worth noting the following:

1. A much clearer distinction between different lines of defence. This will be particularly relevant in how the regulator approaches investigations. Firms should consider carefully how these functions interact, and their respective roles in crisis situations.
2. Non executive director roles are now linked explicitly to the Chairs of the Board and its various sub-committees. This will tend to focus regulatory attention on a smaller number of individuals and may lead to significant changes in how Boards operate in practice.
3. By extension of the greater distinction between lines of defence, there may be a sharper focus on the roles of the broader operations' control functions, specifically COO (only an SMF for Enhanced firms) and CFO. Given this, special attention should be paid to drawing up their SoRs.

Certification & Fit and Proper checks

A key proposal, one that should smooth the overall transition considerably for firms, is that SMFs should have a year from the date of conversion to assess the competence and conduct of their certified staff. However, the relevant staff will still need to be certified from day one.

In a similar vein, and a point that became clear during the first consultation process, the requirement for regulatory references to go back six years will not be applied retrospectively. Neither will additional fit and proper checks for criminal records need to be carried out on SMFs who are existing holders of controlled functions.

This decision not to apply SM&CR provisions retrospectively is a key part of the regulators' approach (the PRA took the same view for banks) and avoids imposing what would be a significant burden on firms. **However**, we would strongly advise firms not to see this as a reason to postpone, or downgrade the importance of putting in place the right systems to enable compliance with these requirements.

Miscellaneous

The consultation on transitional arrangements contains a number of other useful updates or confirmations in areas where there may have been some doubt. These are the main ones:

- The Appointed Representatives regime will remain in place.
- The FCA has reviewed feedback on its proposal to restrict the FCA Register to recording the names of SMFs. This would have meant a significant reduction in the level of transparency, since it currently carries the names of the much larger number of controlled function holders. It will now consult on options by summer 2018.
- Firms will need to complete the REP008 form, which notifies the FCA annually (in October) of any breaches in Conduct Rules. This form will be subject to the Fines for Late Returns regime.
- Forms will be able to be submitted electronically through the FCA's Connect system.

Insights from the consultation period

From the discussions we have had since the summer, with a wide range of firms across sectors and with regulators, these are the main issues and potential problems that warrant greater focus:

- **Groups (Firms):** For firms, these questions include how to implement the regime, which applies at the level of regulated entity, in Groups where there is an Enhanced firm as well as one or more Core ones. These include, whether it is easier (and cheaper) in the long run to apply an Enhanced approach across the Group as far as the regulator allows (see below), and how much use to make of the SMF 7 (Group Entity role).

- **Groups (Regulators):** For regulators, how best to supervise Groups has always been a challenge with no perfect answer. The FCA's current approach, however, which effectively focuses on sectors at the cost of the bigger picture, is ill-suited to an accountability regime that explicitly allows for a Group approach.
- **Choice between regimes:** This was the focus of Grant Thornton's response to the consultation. Our discussions with firms had highlighted the inflexibility of the FCA's proposals in regard both to:
  - (i) Core firms' inability to use Enhanced SMFs that reflected how they ran their business (e.g. COO – SMF 24)
  - (ii) Firms that were in Groups (see above), or that were currently Core but expected to move through the Enhanced threshold in the next two to three years.
- **Certified staff:** We have always believed that Certification has at least as much potential to affect firms' operations as the far more prominent Senior Managers' regime. If anything, our discussions to date have reinforced this conviction. Its importance takes four broad forms:
  - **Numbers:** Given the management and administrative burden of Certified staff, controlling their numbers sensibly should be a priority for all firms. For many, however, the cultural impact of this is likely to be significant and will require careful judgements and inevitable trade-offs.
  - **Initial certification:** Depending on the role of external qualifications in your sector, this may prove more problematic than it did when Certification was introduced in banking.
  - **Fit and proper (CRB checks):** This is a stiffening of the existing certification regime and, while it is only mandatory for SMFs, we suspect many firms (particularly the larger ones) will choose to play safe and extend CRB checks to certified staff, incurring the accompanying administration costs.
  - **Training:** Given the requirements around Conduct Rules (both for SMFs and Conduct staff), and the FCA's adoption of SM&CR as a tool to change firms' culture, it seems likely that firms will have to re-imagine what training looks like for different groups of staff. Most obviously, good practice will require the integration of SM&CR training with their mainstream offering rather than leaving it as a regulatory add-on, and will start to move away from a "sheep dip" approach.

10. How regulators may apply the SM&CR in practice

Introduction

This chapter is based on the interplay of three factors:

i) How the FSA/FCA has supervised previous scope extensions

ii) Our understanding of how the FCA and PRA have supervised the first wave of SM&CR

iii) Our broader knowledge of the FCA's operating model and supervision

It is arranged as a set of predictions (our judgement is that they are more likely than not) about how the FCA will supervise against the SM&CR, especially in the early days. Some of these will be intentional on the part of the regulator, others unintentional and the product of other factors. We hope they will help your firm make its choices around how to implement and re-calibrate its relationship with the FCA post SM&CR.

Predictions

The balance of the FCA's approach will be reactive and event driven: The FCA's resourcing model means that only a small number of regulated firms are part of what it calls the fixed portfolio (that is, firms with a named person supervising them), and a significant portion of these are dual-regulated deposit takers and insurers. As a result, only a minority of even the Enhanced firms will be fixed portfolio. This means that, for the most part, the FCA's interaction with firms will be after a conduct failure has occurred.

The SM&CR will become a natural focus of future thematic work: Thematic work is the regulatory tool the FCA uses to identify problems as they are emerging across a peer group or sector. The aim is to be forward looking, although the reality is that use of the tool is dominated by problem areas that are already known. Given the significance of the SM&CR, there are likely to be a series of themes over the next few years that are focused, directly or indirectly, on how effectively it is working.

In the early days, two obvious targets for an SM&CR-type theme will be peer groups of Enhanced firms (particularly those that are largely in the flexible supervision portfolio), and firms in sectors seen as being higher risk and with relatively weak cultures. As resources become stretched, the SM&CR may well become a common focus for s166 Skilled Person reports.

Enforcement action against individuals will continue to be rare: A combination of resource constraints and an understandably low appetite for losing cases will mean that the number of the SM&CR cases in the FCA's enforcement pipeline at a given time will always be small. In addition, the more senior the person and the larger the firm, the longer a case is likely to take to resolve.

A potential unintended consequence of the shape of SM&CR is that it may prove easier for the FCA to take action against individuals in Certification functions than against SMF holders, as the causal link between the individual and the conduct failure may be shorter and more direct. If so, the regulator will need to consider carefully the precedents it wants to set. That said, the original driver of the SM&CR involved making Enforcement action against senior individuals a more lively option and we assume the proposals have been drafted with this in mind. It goes without saying that the level of political interest in this aspect of the regime will be high.

The **boundary** between Enhanced and Core regimes will, fairly quickly, become **blurred**: There are a number of reasons for this, including the following:

- Supervisors will implicitly expect SMFs in Core firms to know more about the firm, beyond their statements of responsibilities.
- The categorisation of firms may make sense from a policy perspective but is likely to prove difficult for supervisors on the ground, who are already calibrating firms against a number of different and often conflicting scales of complexity and impact.

- Groups containing a number of regulated entities, one of which is Enhanced, may decide to adopt a single, coherent approach. In part, this will be a hedge against supervisors' expectations.
- Given the reach of the Certification regime and the Conduct Rules, larger Core firms may decide that a more comprehensive approach, closer to the Enhanced regime, is simpler, and maybe even cheaper, to implement.

The FCA will find it challenging to provide a consistent approach: To an almost unique extent the SM&CR will reach across all sectors and all regulatory functions – Policy, Authorisation, Supervision and Enforcement – each with slightly different priorities. As a result, firms may get a different answer depending on which part of the FCA they are dealing with.

In the early days, supervisors will be (understandably) nervous when investigating conduct failures: the SM&CR is new for most supervisors as well as firms and, given the origins of the policy (and conscious of the likely high levels of senior interest in the investigation), they may default into a more formalistic approach to firms than they would normally use.

The SM&CR will quickly become a visible step towards a greater focus on more immediately effective and problem-specific regulatory tools: Since it announced its new strategy at the end of 2014, the FCA has been trying to operate more at a "market" level, with a greater emphasis on market studies and competition tools. These tools, while powerful, are expensive to use, slow-acting, and can be overly heavy-handed. Meanwhile, conduct problems keep arising at the firm level. The SM&CR will prove popular with Supervision and Authorisation staff because it provides a new set of specific tools they can use to address particular problems.

The definition of "reasonable steps" is unlikely to change greatly: The Tribunal judgement on the Pottage case remains the best description of what these should involve, though obviously each case will be different. It's not clear yet what this means for the regulators' ability to hold individuals to account, but it clearly places a greater focus on the accuracy of Statements of Responsibility, and on SMFs ability to evidence that they took those steps.

The distinction between the FCA's fixed and flexible portfolios will matter even more: The effect of this difference has been discussed briefly above, and firm conclusions will need to wait until the FCA has published, and then implemented, its "Approach to Supervision". However, the FCA's approach to transition and what we already know about the impact of Brexit on the regulators' priorities and resource planning, seems highly likely to accentuate the differences between the two supervisory approaches.

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