Society of Mortgage Professionals
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Good Practice Guide

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Senior Managers & Certification Regime for Mortgage Professionals

This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Society of Mortgage Professionals' understanding of the regulator's rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

in association with Paradigm MORTGAGE SERVICES

Foreword

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The FCA make sense of a firms' 'culture' by defining it as "the habitual behaviours and mindsets that characterise an organisation".

To measure culture the FCA do not intend to attempt to assess mindsets and behaviours directly, instead they recognise that there are a number of key drivers of behaviour, many of which the FCA and firms themselves can identify and therefore measure. The FCA has set out their focus on four key drivers: a firms' purpose, leadership, approach to rewarding and managing people, and governance arrangements.

Paradigm Mortgage Services are delighted to be working in conjunction with the Society of Mortgage Professionals on this Good Practice Guide to support intermediaries preparing for the Senior Managers and Certification Regime (SM&CR).

In this publication we set out in some detail the FCA's requirements and expectations under the new regime and how they apply to the three tiers of staff within a business: the business owners, the advisory staff and the administration staff.

But the challenge for firms, is not just to understand and put into practice the new requirements expected by the FCA. Rather, if we are to embrace the new regime, we do have to show strong leadership and review our firms' systems, controls and governance arrangements to ensure that they are aligned to generating positive outcomes for our clients, creating transparent, customer centric propositions and providing all staff with a clear, ethical path to follow.

What is the SM&CR?

The Senior Managers & Certification Regime (SM&CR) is a programme designed by the FCA to improve 'trust in financial services' by making the right people in financial services firms accountable for their decisions.

The programme originally came about in response to the 2008 financial crisis where it was felt that not enough action was taken against the banking sector. The SM&CR originally applied to banks and building societies in 2016 and is now being extended to include brokers, financial advisers, fund managers, insurers and reinsurers.

Andrew Bailey, Chief Executive of the FCA, said:

"Trust in financial services will only be rebuilt when the public truly believe that senior managers in our financial institutions are taking responsibility for the actions they take."

As a result, much of the SM&CR focuses on:

- Who the senior managers are in a firm;
- What they are taking responsibility for; and
- What happens if they fall short of their responsibilities.

The SM&CR comes into effect for solo-regulated firms from 9 December 2019 and will replace the Revised Approved Persons Regime (it will not apply to Appointed Representatives). There are also two transitional provisions to help firms move to the new regime:

Firms must identify their Certification Staff before the Commencement date of 10 December, but will have 12 months afterwards to complete the initial certification process.

Senior Managers and Certification Staff must be identified and trained on the Conduct Rules by the Commencement date, but firms will have 12 months to train their other staff.

Identifying Senior Managers within the firm

The FCA cannot oversee the hundreds of thousands of people who work in financial services. As a result, it has split those who work in financial services into three groups according to staff seniority and exposure to the public:

Senior Managers

These are the people who the FCA will spend the most time overseeing 'Senior Management' Functions (SMFs), namely chief executives, executive directors, and other executive and overall responsibility functions. This will vary by size of firm – and for very small firms can be just one person.

Significant Harm Functions (SHFs)

For SMF-holders whose roles "are deemed capable of causing significant harm to its customers". It will primarily be the role of the firm to oversee these people and issue them with a certificate every year to confirm that they are fit and competent to do their role. Although the FCA will not oversee these people directly, the system of certification will allow the FCA to identify very quickly who was delegating authority to them, and whether they were delegating that responsibility in an appropriate way. These individuals are often referred to as 'certified individuals'.

Other staff

All other employees except 'ancillary staff' (post room, security guards, etc). These are staff that are unlikely to cause significant harm to customers. It is the responsibility of firms to ensure they behave in a competent and ethical way by creating a strong organisational culture.

Types of firm

The SM&CR will apply to all advisory and non-advising firms. Almost all firms will fall into the category of either a 'Limited Scope' or 'Core' firm.

If the firm is a Partnership, a Limited Company or a Limited Liability Partnership (LLP), it will be classed as a 'Core' firm. For a sole trader the firm will be a 'Limited Scope' firm. There is also a third category, an 'Enhanced' firm, which can be one of the following:

- significant IFPRU firms
- CASS large firms
- firms with assets under management of £50bn or more as a three-year rolling average
- firms with total intermediary regulated business revenue of £35 million per annum, calculated as a three-year average
- firms with annual revenue generated by regulated consumer credit lending of £100m or more calculated as a three-year average
- mortgage lenders or administrators (that are not a bank) with 10,000 or more regulated mortgages

For those firms who hold 'Certified Function' positions, for example CF11 Money Laundering Reporting Officer, this will be replaced by the function SMF17 – Money Laundering Reporting Officer function. For those firms who do not currently hold 'CF' functions, they will be given new SMF functions. For example, a sole trader with no employees will be required to hold the SMF16 - Compliance Oversight position.

Taking responsibility

Responsibilities for **senior managers** are significant, and require a demanding compliance structure:

- Requirement for prior FCA approval: for each person appointed to perform one or more SMF, before the person takes up the function. An 'overlap rule' will be applied in the case of when more than one SMF is to be held by the same person (approval needs to be granted for each individual function on the same application);
- Statement of responsibilities: setting out which aspects of the firm's affairs that person will be responsible for managing. For larger firms, a 'management responsibilities map' will show details of reporting lines, including how SMFs have been allocated;
- Allocation of prescribed responsibilities: there is a long list of prescribed responsibilities, such as compliance with regulatory requirements, and training and professional development; and
- Duty of responsibility: this requires senior managers to take reasonable steps to prevent poor outcomes for customers. It means that senior managers can be punished for things they should have done but did not do, as well as being punished for things they actively did wrong.

Certified individuals undertaking SHFs will need to meet certain requirements in order to be issued with a fit and proper certificate, which is valid for 12 months. It indicates that the employee is assessed in terms of honesty, integrity, reputation, as well as whether the person has the necessary qualifications, training, competence and personal characteristics to perform their role.

When firms are allocating responsibilities to individuals, they only need to have SMFs for duties they currently have. They do not need to hire extra staff to fill roles that otherwise do not currently exist.

When certified individuals move from one role to another, the previous employer(s) must give a regulatory reference. The FCA expects that any misconduct that led to formal disciplinary action will be included in a regulatory reference. As a result, misconduct by certified individuals can have a very significant impact on their career.

Conduct Rules

This applies to all other staff, except what SM&CR calls 'ancillary staff'. It comprises a variation of the FCA Approved Person regime that firms adhere to already, and CII members will see compatibility with the CII's Code of Ethics. The FCA proposes to create two tiers of Conduct Rules: those for most employees within the firm (except ancillary staff), and those for senior managers:

Individual Conduct Rules:

- You must act with integrity.
- You must act with due skill, care and diligence.
- You must be open and cooperative with the FCA, the PRA and other regulators.
- You must pay due regard to the interests of customers and treat them fairly.
- You must observe proper standards of market conduct.

Senior Manager Conduct Rules:

- You must take reasonable steps to ensure that business [you are running] is controlled effectively.
- You must take reasonable steps to ensure that the business [you are running] complies with relevant requirements and standards of the regulatory system.
- 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.
- You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice. within 7 business days.

Being accountable

The SM&CR is designed to place a greater importance on accountability rather than just imposing fines.

By making individuals personally accountable for their actions, the SM&CR aims to promote a 'Duty of Responsibility' that encourages self-governance and ethical behaviour.

For senior managers, the FCA must be notified within seven business days of concluding disciplinary action using form D (or Form C where the individual will no longer be approved) via the FCA's 'Connect' system. For other individuals, the FCA require the notification to be made annually using REP008 on the FCA's 'Gabriel' reporting system.

The FCA will then maintain a public Financial Services Register, 'the FS Register', with only approved firms and individuals appearing on the published list. Under certain circumstances it may be appropriate to take action against both the individual and the firm.

The criteria of how the FCA will discipline individuals, or those that fail to report their actions, is outlined in the Decision and Procedure and Penalties Manual (DEPP).

Types of disciplinary action can be summarised as:

- Issuing of a formal written warning;
- Suspension or dismissal of a person; or
- Reduction or recover of remuneration.

The new reporting requirements do not change the firms' obligation to report concerns about an individual's conduct under existing rules and principles, such as Principle 11 (Relations with regulators: a firm must deal with its regulators in an open and cooperative way; and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice).

Good practice

1. Think about customer outcomes first

The SM&CR is only a means to an end – encouraging trust in financial services by reducing harm to consumers. Therefore, the best way to start with the SM&CR is to think about the risks that clients face and how you help prevent them from harm.

For example, what due diligence do you take to make sure that any business you are providing does not mislead their customers about the risks of an investment, or the charges or surrender penalties of mortgages? It is important for the owner or the board of the business to ask, who is responsible for this analysis? How is it updated? Who is responsible for maintaining these processes? Are there any potential conflicts of interests? How do we gather feedback? Who is responsible for acting on that feedback?

Once you have a clear picture of the risks, establish who in your firm is identifying and managing those risks, and how close the firm is to its clients' experiences.

2. Think about creating the right culture

Processes on their own are not enough to prevent harm – creating good outcomes for customers involves individuals behaving in a competent and ethical way, day in and day out. This can only be done if the culture of the firm is focused on doing the right thing over the long term – not just doing what it takes to survive until tomorrow.

The FCA has encouraged firms to think about a strong organisational culture as an output. The inputs that managers have control over include:

- its purpose;
- the way it is led;
- its governance processes and incentives; and
- the diversity of people who work with it (especially as firms grow).

The crucial point is that all these inputs have to add up to good outcomes for consumers. A firm has to reflect the interests of the clients it serves. By creating a better organisational culture they are better equipped towards truly understanding and providing for their customers. No firm can say, "we have a great culture, even though our clients don't always get what is in their best interests".

The relationship between culture and inputs are summarised in this diagram:

3. Clearly identify your firm type and staff

Once you have thought about how you deliver good outcomes for customers, deciding who should be senior managers and who should be certified individuals should be relatively straightforward.

You should aim for the right balance between concentrating accountability and building a comprehensive view of the organisation. The best presentation is one that shows ultimate accountability being concentrated in a small number of individuals.

Start by identifying whether you know whether your firm is classed as a ‘Limited Scope’, ‘Core’ or ‘Enhanced’ firm. You should then create a structure chart which clearly defines all reporting lines and senior management positions. This organisational chart should then make it easy to identify the staff that will fall under the Senior Managers Regime, staff that fall under the certification scheme and staff that will fall under the Conduct Rules.

4. Keep up to date

Firms need to make sure that all members of staff comply with the code of conduct. However, the best tools to address this with are training, people management and by building a strong organisational culture.

The tools used for concentrating accountability are not necessarily the tools that should be used for disseminating good practice.

By remaining on top of the list of PRA conduct standards, you will now be able to track and measure the progress of your staff as well as understanding when someone undertaking SHFs are not meeting their requirements.

By certifying individuals as ‘fit and proper’ every 12 months basis you will be able to monitor whether the firm is being run efficiently and ethically on a more regular basis. The certification will not just apply to the employee’s honesty, integrity and reputation, but also whether they are up to date with their training, qualifications and general competence.

5. Make sure you’re prepared

Always expect the unexpected. Unforeseen circumstances and last minute changes can affect every firm, which is why you always need to maintain your resilience:

The 12-week rule

If a Senior Manager is unexpectedly absent (eg sickness, personal emergency), you are allowed to appoint a temporary replacement, for up to 12 weeks, without needing approval from the FCA.

Outsourced roles

If your firm relies on a third party for the operational functions of the firm, your firm is still fully responsible for carrying out all of its regulatory obligations. While you may outsource the function, you can’t outsource accountability for this function.

References

You are now required to obtain references from current and previous employers of at least six years for senior managers and those fulfilling SHFs. This will give you more peace of mind in ensuring that adequate background checks are taken. When providing a reference, you should also use a standard template, disclosing any relevant information covering the previous six years, assessing whether the candidate is fit and proper for the new role.

Conclusion

Some experts are already saying that the SM&CR will revise senior executive behavior. It could encourage managers to go straight to the FCA, rather than via the normal compliance channels, in order to mitigate risk of retribution if a firm is found to be in breach. This suggests a fundamental change of approach. It could help the FCA be more receptive to whistleblowers contacting the regulator directly.

By clearly outlining levels of responsibility, the SM&CR will make it easier not just to identify areas of market abuse or insider dealing, but also to create a culture that promotes the fair treatment of customers. Aligning all financial services in this way will give customers greater confidence that a consistent and regulated system is in place.

Appendix - Primary source material

Financial Conduct Authority

- **CP17/23: Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms,** *https://www.fca.org.uk/publication/consultation/cp17-25.pdf*
- **CP17/40: Individual Accountability: Transitioning FCA firms and individuals to the Senior Managers & Certification Regime,** *https://www.fca.org.uk/publication/consultation/cp17-40.pdf*
- **CP17/42: The Duty of Responsibility for insurers and FCA solo-regulated firms,** *https://www.fca.org.uk/publication/consultation/cp17-42.pdf*
- **The Decision Procedures and Penalties manual,** *https://www.handbook.fca.org.uk/handbook/DEPP.pdf*
- **PS18/4: Extending the Senior Managers and Certification regime to FCA firms – Feedback to CP17/25 and CP17/40, and near final rules,** *https://www.fca.org.uk/publications/policy-statements/ps18-14-extending-senior-managers-certification-regime-to-fca-firms*
- **PS18/6: The Duty of Responsibility for insurers and FCA solo-regulated firms,** *https://www.fca.org.uk/publications/policystatements/ps18-16-dutyof-responsibility*
- **The Senior Managers and Certification Regime: Guide for FCA solo-regulated firms,** *https://www.fca.org.uk/publication/policy/guidefor-fca-solo-regulatedfirms.pdf*

HM Treasury

- **Policy paper: Senior Managers and Certification Regime: extension to all FSMA authorised persons,** *https://www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorised-persons*

Prudential Regulation Authority

- **CP28/17 - Appendix 3: Draft SM&CR forms,** *https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2017/cp2817app3*