Policy Briefing

Personal Finance Society
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Widening the Senior Managers & Certification Regime (SMCR) to all regulated firms: update and analysis

Key Points:

- The Senior Managers and Certification Regime (SMCR) which has caught senior executives and important functions in banks since 2016 is extending to all firms including the financial advice sector.
- This is driven by the regulator to rebuild public trust in the sector by creating a robust responsibility and accountability process for senior managers across the financial services sector.
- For firms new to this, the regime will be more onerous than the Approved Persons and Controlled Function regime that it replaces.
- In July 2017, the FCA published consultation CP17/25 setting out how the regime will be amended to bring in the 50,000+ people outside the "deposit taking institutions". The consultation closes in November, and the regulator will publish rules in mid-2018.

What is the SMCR?

The Senior Managers & Certification Regime (SMCR) is a new regulatory framework for similar fitness, propriety, conduct and accountability standards for individuals holding positions of responsibility within financial services firms.

At its core are comprehensive standards split depending on staff seniority and exposure to the public:

- **Senior Managers:** for senior staff filling "Senior Management" Functions (SMFs), namely chief executives, executive directors, and other overall responsibility functions. This varies by firm size;
- **Significant Harm Functions (SHFs):** for SMF-holders whose roles "are deemed capable of causing significant harm to its customers";
- **Other staff:** all other employees except "ancillary staff" (post room, etc).

What firms will this apply to?

The FCA is tailoring the regime depending on the nature of risk and management structure.

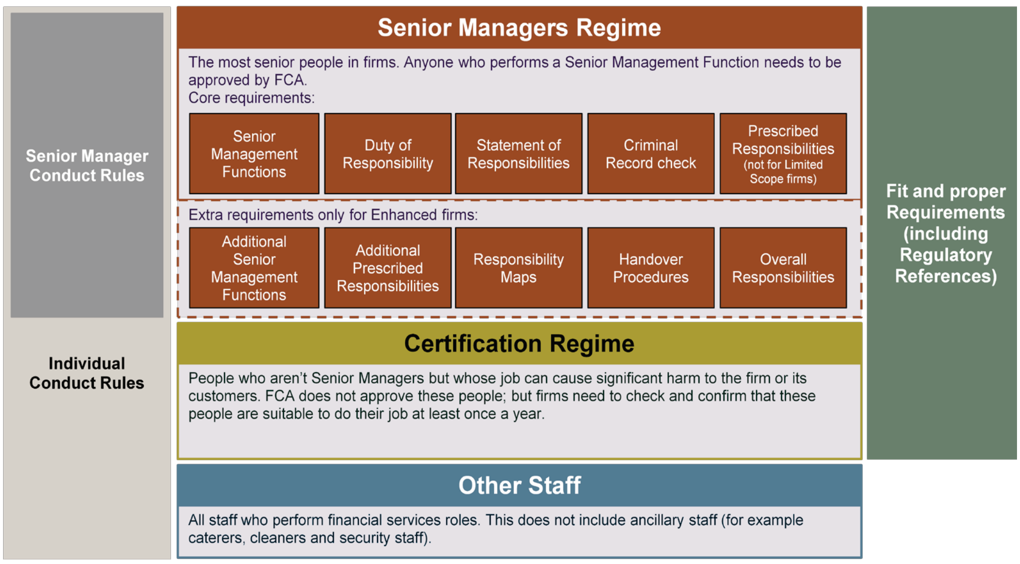
- **Core firms:** most FSMA firms will come under this.
- **Limited scope firm:** with limited application to Approved Persons have fewer requirements. Most sole-trading financial advice firms would come under this category.
- **Enhanced firms:** about 350 FCA-only regulated firms that meet one of the six criteria that will have more stringent requirements.

Senior manager responsibilities

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

- **Requirement for prior FCA approval:** for each person appointed to perform one or more SMFs, before the person takes up the function;
- **Statement of responsibilities:** setting out which aspects of the firm's affairs the role will be responsible for. "Management responsibilities map" detail reporting lines, including how SMFs have been allocated;
- **Allocation of prescribed responsibilities:** a long list of prescribed responsibilities, such as compliance with regulatory requirements, and training/professional development; finally

Senior Managers & Certification Regime (adapted from FCA CP17/25)



- **Duty of responsibility:** assesses the reasonable steps the senior manager could have taken, and creates a third ground in which a senior manager can be disciplined in the event of misconduct.

Certification regime

Those undertaking SHFs will need to meet certain requirements in order to be issued with a fit and proper certificate 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 the role.

Conduct rules

This applies to all other staff except what SMCR 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.

In the consultation, 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.

Fit & proper requirements and regulatory references

These now apply to both senior managers and those fulfilling significant harm functions. Firms must take reasonable steps to obtain appropriate references from the person's current and previous employers to six years.

Analysis: conduct and culture are on the regulatory agenda

The main reason for merging and extending the two regimes is regulator interest in improving culture and ethics within all financial services firms.

When SMCR is extended by the end of 2018, 50,000+ new staff members will be brought into the regime, and the FCA are clearly going to great lengths to ensure that this regime is applied as proportionately as possible. They are clearly aware of the complexities involved. As Jonathan Davidson (FCA Director of Supervision – Retail and Authorisations) said in August 2016, a year before the consultation was published:

- "We are cognisant of the diversity of firms this will bring under the regime, and proportionality will play a key role as we work to ensure SMCR works across all sectors."
- "But the tenets of the regime – clarity, accountability and transparency – will not change. And our expectations around conduct, whether the firm is large or small, will remain high."

The real challenge is to ensure that the regime remains first and foremost an exercise in improving firm culture. With regulation as complex as this, there is always a risk that the engineering involved in complying overtakes the spirit of its intention. The individual and senior manager conduct rules might in themselves play a part.

Andrew Bailey: "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."

According to Andrew Bailey at an FCA press conference: "One of the big questions here, we're taking it from the banks to the whole world of FCA firms, which is a large number, so getting the proportionality right, to your point that some of them are one-person firms, is critical."

This suggests a fundamental change of approach. It could help the FCA be more receptive to whistleblowers contacting the regulator directly.

How the PFS can help: ethics and culture

Firms currently outside the SMCR and SIMR that will be caught by the extended regime will recognise that this goes well beyond the existing FCA Approved Persons.

They might consider their current governance structures and how responsibilities are currently allocated within the firm. The key area over and above the current APER regime will be the emphasis on ethics and culture and this happens to be the area where the CII can help.

We have published a range of material to help especially smaller firms consider their approach to ethics and culture, and we are developing more to help firms demonstrate this.

Ethical Culture: Developing a Culture of Personal Responsibility in a Regulated Environment

www.cii.co.uk/39598

Ethical Culture: A Practical Guide for Small Firms

www.cii.co.uk/27327

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