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Insight and foresight

Extension of the Senior Managers
and Certification Regime –
a Practical Guide





Introduction

The Senior Managers & Certification Regimes (“SMCR”), which applies to banks and PRA designated investment firms, will be extended to apply to all authorised firms, including insurers, investment firms, asset managers, insurance and mortgage brokers and consumer credit firms.

The government anticipates that the SMCR will come into force for these other firms during 2018.

We have been working extensively with banks across London on their SMCR implementation projects, and have seen first hand the scale and complexity involved. Firms are often required to consider and implement fundamental changes to their management and governance structures, and put in place large amounts of new documentation, systems and processes, against a backdrop of developing draft rules and constantly evolving regulatory expectations and industry practice.

This guide is aimed at those firms who will be brought within the scope of the extended regime. We have set out our key insights into the SMCR, which we hope will help to guide firms as they begin to plan for, and embark on, their implementation projects. In addition, this guide may trigger thoughts in relation to any lobbying you might wish to undertake as the rules for the new regime develop.

Please do get in touch with any of the contacts listed at the back of this guide if it would be helpful to discuss your project in greater detail.

Key Messages

1. Implementation requires clarity on, and documentation of, complex relationships between executive management and its reporting lines, governance and risk management structures.
2. The regulator’s jurisdiction will extend significantly to include a much larger proportion of a firm’s employees – implications for recruitment, training, appraisal and disciplinary processes.
3. The risks of getting this wrong are serious – implementation is likely to be among the first questions asked in any investigation.
4. As such, managing implementation is a complex and sensitive task, taking into account detailed rule requirements meshed with the organisation and culture of the firm.



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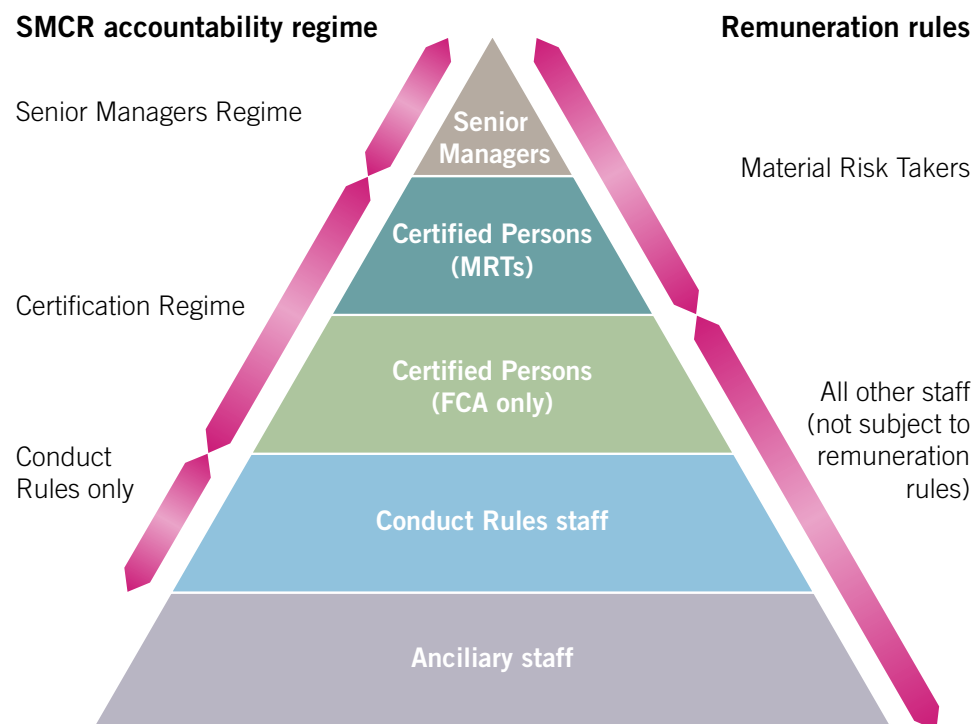
1.0

1.0 SMCR – the basics

1.1 Senior Managers Regime

- > Clear allocation of various designated senior management responsibilities.
- > “Statements of Responsibilities” to record the allocation of responsibility to individual Senior Managers.
- > “Responsibilities Map” to be a single document describing the firm’s management and governance arrangements in order to demonstrate that there are no gaps in accountability.
- > Where there has been a breach by the firm of its regulatory obligations in relation to an area within a Senior Manager’s remit, the regulator could take action against the Senior Manager for failing to take ‘reasonable steps’ to avoid a breach occurring or continuing.
- > Must create handover documents which should have necessary information to allow new Senior Managers to perform their new responsibilities effectively.

Figure 1



“FIRMS MUST NOTIFY FCA OF BREACHES OF CONDUCT RULES.”

1.2 Certification Regime

- > Firms must annually certify that individuals are fit and proper to perform specified functions which could involve a risk of ‘significant harm’ to the bank or any of its customers.
- > Such individuals will not be subject to regulatory approval; rather it is a firm’s responsibility to ensure that they are certified as fit and proper to perform their functions.

1.3 Conduct Rules

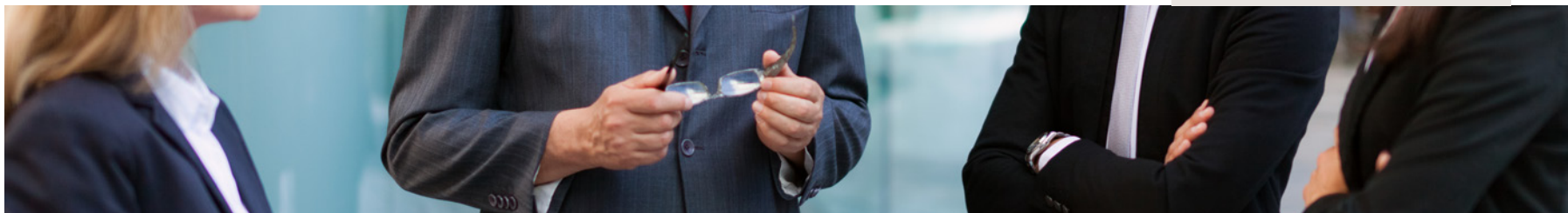
- > Will replace current Statements of Principle for Approved Persons (APER), and will apply to a wider range of individuals - Senior Managers, Certified Persons, and all other bank employees unless specifically excluded (e.g. facilities management, IT support, invoice and data processors, PAs etc).
- > Firms must:
 - Notify all relevant individuals that they are subject to the Conduct Rules.
 - Give all relevant individuals training on Conduct Rules – to include ‘deeper understanding of the specific rules which are relevant to their work’ (e.g. traders might be given tailored training on market conduct issues).
 - Notify the FCA of breaches of Conduct Rules.



Key Implementation Issues: an overview

Depending on the size, scale and complexity of an institution's functional governance structure and reporting arrangements, we would expect an implementation plan to at least comprise the following steps. Further detail on these stages is given in the subsequent pages (Section 2).

Implementation Project Team	Devise & agree Design Principles	Undertake Scope analysis	Gap analysis Rules vs. Existing Arrangements... plus enhancements	Identification of Senior Managers	Preparation of Responsibilities Map	Amendments to legal documentation and risk management arrangements	Application to register Senior Managers and grandfathering	Training to all impacted staff
<p>></p> <ul style="list-style-type: none"> - Who? - Representation across functions and regions - Approval and sign-off how? 	<p>></p> <ul style="list-style-type: none"> - Early stage project plan - Articulation of key targets, outputs, timeframe and guiding principles - Early statement of firm culture to be agreed, expressed and embedded 	<p>></p> <ul style="list-style-type: none"> - Territorial scope - Impact on branches and subsidiaries - Personnel in scope? How far down to look? - Potential structural changes to limit scope both geographical and functional 	<p>></p> <ul style="list-style-type: none"> - Identification of gaps in current structure - Enhancements - how agreed, who signs off? - Impact across regions, buy-in and approvals required, impact on timing - Validation of enhancements for SMCR against local requirements 	<p>></p> <ul style="list-style-type: none"> - Mapping of prescribed responsibilities to appropriate Senior Managers - Identification of Certified Staff 	<p>></p> <ul style="list-style-type: none"> - Preparation of Statements of Responsibility - Clear demarcation of role and responsibility - Individual accountability 	<p>></p> <ul style="list-style-type: none"> - Preparation of new policies and procedures e.g. for breach reporting - Implementation of enhancements arising out of gap analysis, e.g. to governance structure 	<p>></p> <ul style="list-style-type: none"> - For applications to be approved, implementation of SMCR must be live 	<p>></p> <ul style="list-style-type: none"> - Update training for SMs - "from scratch" training for many newly certified staff and some SMs - Ongoing training to validate certification



2.0

2.0 Impact on implementation

2.1 Project management and threshold considerations

The right team.

- > Determine the appropriate staffing and governance for implementation project.
- > Often helpful to establish a cross-functional project team/steering committee with senior executive sponsorship and oversight, to take responsibility for overseeing implementation of the regime.

Development of “key design principles”.

- > Clients have often found it helpful to articulate a set of agreed key “design principles” which will govern the intended approach to implementation. For example, the design principles will seek to articulate an agreed “in principle” decision on key strategic matters such as:

- (a) Future size, shape and roles of board and EMEA Governance Committee (e.g. balance of executive directors and NEDs, representation of control functions)
 - (b) Preferences regarding limiting number of non-UK based individuals to be registered as Senior Managers, and consequences for current matrix/functional management arrangements
 - (c) Approach to attribution of responsibilities/key functions (e.g. concentrating allocation of responsibilities to reduce number of Senior Management Function holders, approach to joint/co-heads)
- > Throughout implementation, design principles would guide key decisions and serve to ensure that processes being developed comply not only with the new rules, but are in line with the relevant institution’s preferred approach and cultural direction.

“For non-UK headquartered groups, individuals in the UK need to consider whether they have sufficient authority and decision-making powers to fulfil their regulatory obligations vis-a-vis the UK entity, while individuals based overseas who are within the scope of the regime need to ensure that they understand the UK requirements and have appropriate oversight mechanisms in place to be able to satisfy these.”

Peter Bevan, Partner

“The Senior Manager identification process forces clients to go “back to basics” and consider and justify the fundamental components of their governance structures. Expect significant challenge along the way as the internal politics unfold. As a result, early strategic planning and senior management engagement are key.”

Michael Kent, Partner

“ SENIOR MANAGERS NEED TO CONDUCT A REVIEW OF LOCAL GOVERNANCE ARRANGEMENTS ”

2.2 Scope

Which entities are in scope.

- > Groups may have banks, insurers, asset managers etc. to which different rules might apply.
- > Need to consider which rules apply to which entities, and how their governance structures interact.

Branches.

- > Where relevant, need to consider application of the regime to EEA and non-EEA branches, to which different rules apply.

Overseas implications.

- > Assessment of business will need to be undertaken by legal entity (taking account of any overseas activities), to establish which businesses, activities and personnel are in scope.

2.3 Senior Managers Regime

Governance evaluation.

- > Need to conduct a review of local governance arrangements (across business/product lines).
- > Dialogue with wider Group is essential, as rules require Responsibilities Map to explain how local governance and Senior Managers report/interface/relate to broader group-wide governance frameworks.

Responsibilities mapping.

- > Guiding principles must be clarity, consistency and simplicity.
- > Documents must reflect the reality of actual business and governance, otherwise they could lead to unacceptable risks for firms and for individuals to whom responsibilities have been allocated.

Senior Manager identification.

- > Identification of Senior Managers and allocation of prescribed responsibilities will only be accurate if such a review is undertaken with business engagement and input.
- > It may be necessary to revisit the size/nature of:
 - (a) non-executive director representation on UK boards (given extensive obligations on chairman) and effective creation of senior independent director function; and
 - (b) composition and structure of executive governance committees, given the likely impact on number of persons requiring approval as SMFs.

“Senior Managers are realising, more than ever, that they need to stay sharply focussed on what their responsibilities are, and how these are fulfilled. The need to prepare to deal with increasingly aggressive regulators has meant that their need for support and guidance has never been greater.”

Nadia Swann, Partner

“ GREATER FORMALISATION MAY BE REQUIRED AROUND BRANCH/SUBSIDIARY GOVERNANCE FRAMEWORK ”

Overseas headquartered firms.

- > Regime presents challenges for UK subsidiaries of an overseas headquartered firm, particularly where there are strong functional (as opposed to geographic) reporting lines and matrix management structures in place.
- > Aim should be to seek to implement requirements without making fundamental changes to a bank's approach to governance. However, enhancements to governance arrangements may be required:
 - (a) Some modifications to local/functional reporting lines may be required to avoid large numbers of overseas staff becoming subject to approval (e.g. stronger reporting lines from control functions into local business management, modification of powers and accountabilities as between local and functional management).

- (b) Greater formalisation may be required around branch/subsidiary governance framework, including interplay between local management and matrix management/functional reporting lines.
- (c) Greater rigour will be needed around rationale for approach (e.g. who has overall responsibility, who exercises significant influence) and documentation of rationale.

Legal / policy documentation.

- > A large amount of legal documentation is required to be put in place – see key deliverables.

Approvals and grandfathering.

- > Need to carefully consider grandfathering provisions to ensure that correct SIFs are registered in order to be able to benefit from them.

Evidencing “reasonable steps”.

- > Greater individual accountability creates heightened risks for individuals.

- > New arrangements need to be implemented in a way that mitigates these risks, by providing infrastructure, support, guidance and enhanced record-keeping arrangements that enable individuals to demonstrate fulfilment of their obligations readily. For example:

- (a) Clarity of extent of first line responsibility for risk management/control (vs. second line), given extensive expectations of first line.
- (b) Clarity regarding individual decision-making responsibility/control vs. collective decision-making through committees.

Employee contracts.

- > Employment contract templates to be re-worked to reflect new requirements.
- > Need to consider whether necessary to amend existing contracts

“Previously, the rules included a “reverse burden of proof” doctrine which was the subject of much media attention, whereby there was a rebuttable presumption that Senior Managers were responsible for regulatory breaches within their remit. This has now been removed. While this is a welcome development, it should not lead firms or senior managers to think that the reforms brought in through the Senior Managers Regime will have less teeth. As the FCA's announcement in response to the changes makes clear, the regulators “remain committed to holding individuals to account where they fail to meet our standards.”

Nikunj Kiri, Partner



Insurance and indemnity arrangements.

- > Because of heightened risks to individuals, there is likely to be increased interest in protections offered by firm's for employees, often requiring tightening of documentation.

Handovers.

- > Greater rigour needed around handover process, which will require engagement from incoming and outgoing Senior Managers.

2.4 Certification staff

Identification of Certified Staff.

- > Similar to the Senior Manager identification process, this will require entity-by-entity analysis of which individuals fall within the specified FCA and PRA categories, taking into account matrix management structures and overseas implications of the regime.
- > Because the population of PRA certification staff is the same as the test for identifying Remuneration Code staff, this exercise has often pushed firms to re-consider their analysis in that area.

Fitness and propriety assessments.

- > Burden for certifying fitness and propriety of middle management will shift from regulators to firms.
- > Need to establish processes for ensuring staff remain fit and proper on an on-going basis.

2.5 Conduct Rules

Training materials.

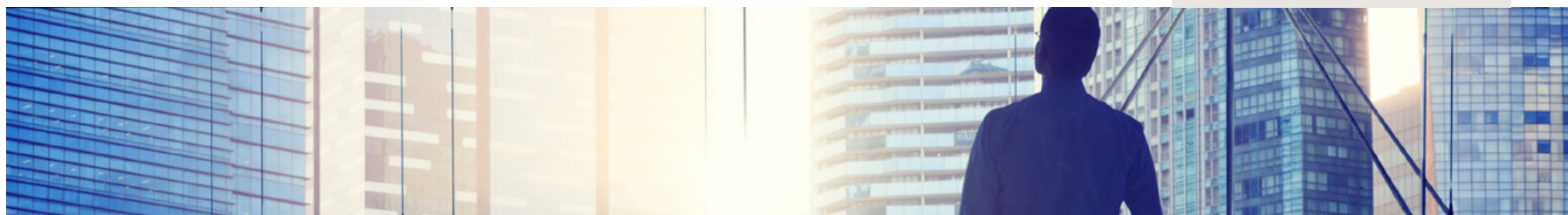
- > Need to develop materials which are tailored to the roles undertaken by the different sections of the Conduct Rules Population.
- > Note that because application of Conduct Rules is far wider than the current APER Principles, many Conduct Rules Staff will need be educated on the relevant principles "from scratch".

Breach reporting.

- > Need to develop systems and processes which will allow for the collection and reporting of data allowing firms to make the determination of whether a reportable breach of the Conduct Rules has occurred.

"The systems-build required to deal with the breach reporting and training requirements should not be underestimated. The translation of a firm's broad and general obligations under the regime into a concrete work plan requires significant cross-functional input, involving Legal, Compliance, HR and IT."

Jean Lovett, Partner



3.0

3.0 Key deliverables

At implementation

Drafted Responsibilities Map
Identified and grandfathered senior management function holders
Allocated PRA/FCA prescribed responsibilities to SMF holders, with documented rationale
Identified certified persons
Assessment of fitness/propriety for SMFs/CPs completed
Statements of responsibility and updated role profiles for all SMF and CP holders
Adjustments to governance/decision-making frameworks, board/committee terms of reference/composition, etc.
Enhancements to Office of Chairman and RemCo, development of SID role
Attestations/confirmations as to compliance with requirements
Training delivered to all SMF/certified persons on obligations, incl. Conduct Rules
Amendments to employment contracts
Amendments to Code of Conduct/whistleblowing/disciplinary policies/ procedures
Updated D&O/insurance arrangements
IT systems infrastructure upgraded to monitor/maintain compliance

Policies/procedures/systems to be operated on a BAU basis

Overall policy for ongoing compliance with regime
Process for updating Responsibilities Map and statements of responsibility
Process for monitoring/updating SMF/certified persons and changes to allocated responsibilities
Processes for annual confirmation/certification/assessment process (fitness and propriety, certification, SMF)
Process for monitoring compliance with Conduct Rules
Process for notifying FCA/PRA of actual/suspected breaches of Conduct Rules and associated disciplinary action
Handover processes
Updated regulatory reference process
Ongoing bespoke training for all staff on Conduct Rules
Enhanced record-keeping arrangements
Ongoing culture/conduct programme
Compliance monitoring/audit arrangements
IT systems infrastructure to maintain compliance



4.0

4.0 Regulating success: Our experience

We would be delighted to assist with your implementation of the SMCR, and believe we would bring significant advantages as your legal advisors on this project.

Market-leading team with regulatory and employment expertise:

- > Our specialists from the financial regulatory and employment teams will work together to provide you with an integrated multi-disciplinary team.
- > Our financial regulation practice operates on a fully integrated basis, comprising partners and associates with both advisory and contentious regulatory expertise. This breadth and depth of expertise is particularly important in the context of SMCR, given the emphasis placed on individual accountability and the increased risk of disciplinary action.

In-depth understanding of the SMCR and its underlying policy objectives:

- > We have an unparalleled breadth of expertise in advising on governance and risk management issues, in both the advisory and contentious context.
- > As part of our work in this area, we have been closely monitoring the development of the SMCR throughout the last year, and have had regular dialogue with regulators and the industry in relation to its operation.
- > It must be testament to this expertise that we have been instructed by several of your peer firms to act as lead legal adviser on their SMCR implementation projects. Our engagement for other clients assists us in providing you with industry benchmarking, insights on the approach being taken by other clients (including how they propose to deal with similar challenges).

Strong relationship with regulators:

- > We maintain strong relationships with the FCA and PRA which gives us an excellent understanding of the regulatory environment and culture.
- > Not only do we have a number of alumni at the regulators, but our team also includes practitioners who have previously held senior positions 'on the other side of the fence'. One of our team members, Celyn Armstrong who is Counsel in our Financial Regulation Group, helped develop the draft rules set out in the SMCR consultation paper while at the FCA.

We are instructed on over ten separate SMCR implementation projects. Our banking clients include many major global institutions with UK branches and subsidiaries. Our work for these institutions includes advising:

- > an overseas headquartered banking group on adjustments to its governance structures and related procedures, including reporting lines, empowerment of Senior Managers, matrix management issues and committee structures, in preparation for the SMCR
- > an overseas-headquartered investment bank on how the SMCR will apply to its UK subsidiary and branch, including producing an inventory of SMCR rules and reviewing the bank's proposed definitions of its certification staff and conduct rules staff
- > as part of a global custody bank's SMCR project, conducting a review of the regulations applying to different business lines and services in order to assist senior managers responsible for those areas in showing "reasonable steps" under the presumption of responsibility.
- > a number of institutions on the proposed processes to identify and monitor their Certified Staff and Conduct Rules populations, including advice on 'overseas issues' and the interaction between the SMCR and the remuneration rules.
- > a number of institutions in relation to the on the SMCR's impact on their remote booking and branch/subsidiary arrangements, including detailed technical analysis on identifying the relevant Certified Staff and Conduct Rules populations, advice on remuneration implications, and the necessary governance and oversight structures.
- > a number of institutions in relation to the 'reasonable steps' that Senior Managers will need to evidence and how this should best be achieved, including through training and advising on associated internal procedures and governance documentation.



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