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The Senior Managers and Certification Regime for FCA- authorised Firms

How the regime will affect your
business and what to do next

Overview

The Senior Managers and Certification Regime (“SMCR”) is a new regime which was developed following the financial crisis of 2008, and is intended to make senior personnel and key staff more accountable for their actions.

While the SMCR currently only applies to banks and PRA-authorized firms, the SMCR is in the process of being extended to apply to all authorized firms. The regime will apply to FCA-authorized firms from mid to late 2019, and will have a significant impact on the governance arrangements within such firms.

The FCA¹ has published draft rules for the SMCR, and has consulted on transitional provisions². Final rules are due to be published in Summer 2018. This note

covers the position under the draft rules. We will reissue an updated version of this note following the publication of the final rules.

Please note that we have a separate note for insurers which is available on request.

1 CP17/25: Individual accountability: Extending the Senior Managers and Certification Regime to all FCA firms (July 2017).

2 CP17/40: Individual accountability: Transitioning FCA firms and individuals to the Senior Managers & Certification Regime (December 2017).



Overview

Different types of firm

- The Regime applies in a different way to different firm types.
- There are three categories of firm each with differing levels of requirements: **Limited Scope**, **Core** and **Enhanced**. Firms will need to determine which category applies to them.

The Senior Managers Regime

- Individuals appointed to perform designated Senior Management Functions will require regulatory approval before commencing their role. Senior Management Functions will replace the current Approved Persons regime at FCA-authorized firms.
- Senior Managers will also be required to have individual Statements of Responsibilities setting out their personal responsibilities. The Statements of Responsibilities must be submitted to the regulators.
- The regulators will prescribe a number of core responsibilities that most firms will need to allocate among the Senior Managers of the firm.
- A Senior Manager will have a “Duty of Responsibility” to take reasonable steps in relation to areas for which the Senior Manager is responsible. Where a problem arises within the scope of a Senior Manager’s allocated responsibilities, the regulators can take action against a Senior Manager who has failed to act in line with this Duty of Responsibility.
- Some firms will need to maintain a Management Responsibilities Map, outlining the governance structure of the firm, including reporting lines and the responsibilities of the Senior Managers.

The Certification Regime

- There will be a new Certification Regime to cover staff who are not performing Senior Management Functions, but who are in a role which, if performed poorly, could cause “significant harm” to the firm or its customers. Under this regime, firms will be required to certify that the individuals are fit and proper to perform their roles.
- The certification will be required to be repeated at least annually. Most firms will need to allocate responsibility for compliance with this regime to a Senior Manager.

Regulatory References

- There will be new rules governing the way in which firms assess the fitness of Senior Managers, Certification Regime staff and Non-Executive Directors. In particular, firms seeking to appoint a Senior Manager or certified person must request a regulatory reference covering such person’s employment for the previous six years.

The New Conduct Rules

- The majority of staff within a firm will be required to comply with new Conduct Rules.
- The only staff who are not required to comply will be those performing ancillary roles (being those roles not involved in the performance of the firm’s regulated business).
- Firms will be required to ensure that all relevant staff are trained on the implications of the Conduct Rules.
- Senior Managers will be subject to additional Conduct Rules. Breaches of those rules will need to be notified to the FCA.

Why is this relevant to my business?

FCA-authorized firms are currently subject to the FCA's Approved Persons regime, which governs the appointment and conduct of senior management and other key personnel. The SMCR will replace this.

The extension of the SMCR will therefore directly affect FCA-authorized firms. It is also of direct relevance to directors and employees of such firms, who may be subject to an increased focus on their individual responsibilities and their accountability for such responsibilities.

Firms should note that there are significant differences between the SMCR and the current FCA Approved Persons regime. In several respects, the SMCR is a more onerous regime. To comply with the SMCR, FCA-authorized firms will need to make changes to governance documentation, compliance and HR procedures and processes, and submit additional documentation to the FCA. There may also be implications for employment contracts and terms of appointment of directors. Please see further details below.

What are the key elements of the SMCR?

Different rules apply to different firms

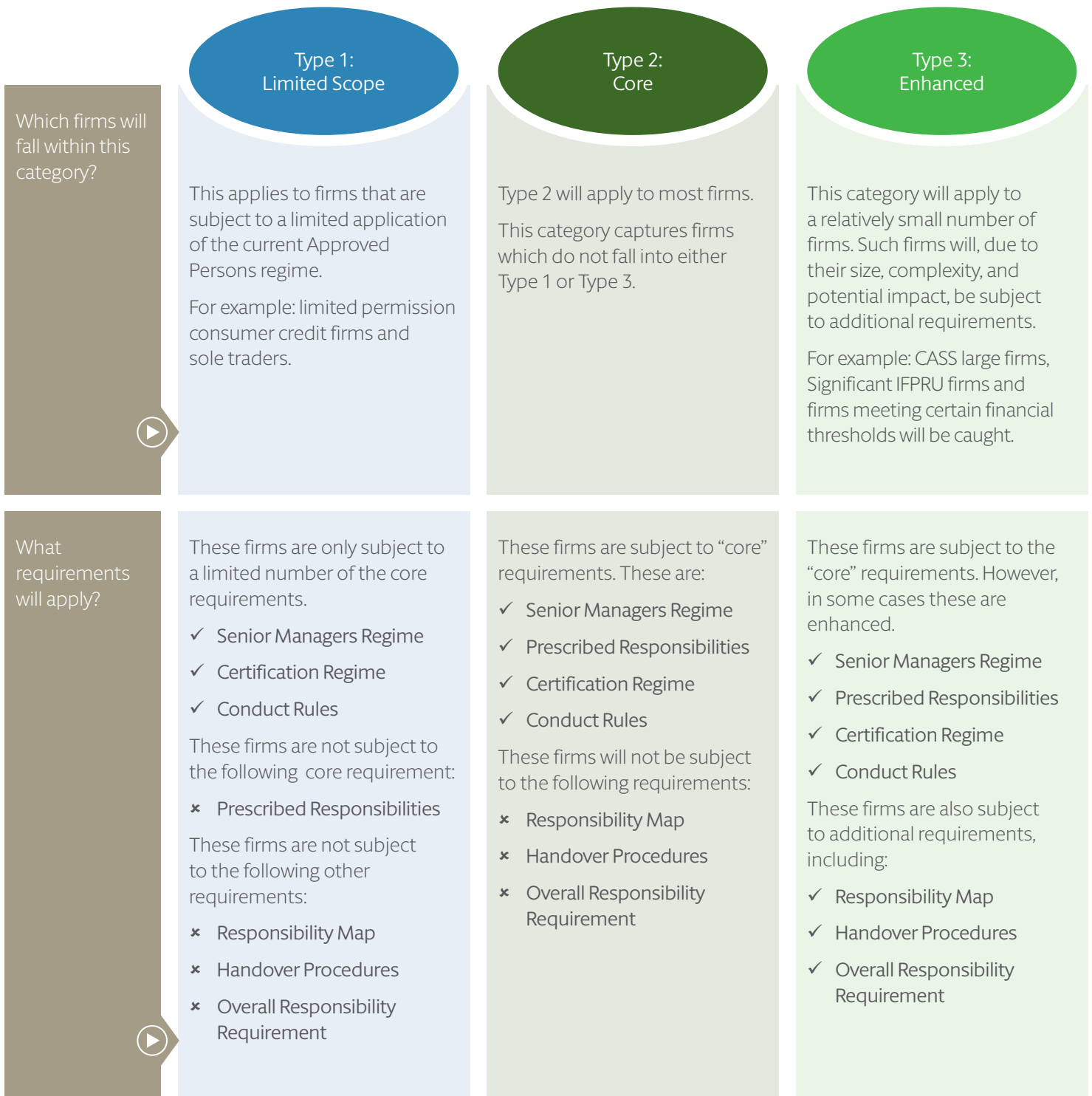
The FCA has acknowledged that there are a range of different types of firm which will become subject to the SMCR, and it would not be appropriate to treat all firms in the same way.

As a result, the FCA has effectively divided firms into three types: Limited Scope, Core and Enhanced. As a starting point, it will be important for firms to determine which category they fall within.



Rules which apply to each type of firm

The diagram below summarises the different categories which will apply to firms and the rules which apply to each.



Senior Managers must be approved

Type 1: Limited Scope	Type 2: Core	Type 3: Enhanced
✓	✓	✓

A person who performs a designated "Senior Management Function" ("SMF") must be approved by the FCA. Please see the **Annex** of this note for the current list of SMFs under the core regime. Type 1: Limited Scope Firms are subject to fewer SMFs, while Type 3: Enhanced firms are subject to additional SMFs.

The good news for FCA-authorized firms is that fewer persons may require prior regulatory approval under the SMCR than under the current Approved Persons regime. For example, under the Approved Persons regime, all directors (including non-executive directors) must be Approved Persons. In contrast, under the SMCR, non-executive directors who do not also undertake one of the roles designated as Senior Management Functions do not require approval.

There is also no equivalent to the Approved Person CF30 role (customer-facing) under the SMCR. However, please note that such persons may be subject to the certification regime (see below).

Some Approved Person controlled functions will convert into SMFs, although it may be necessary for the firm to submit a conversion notification to the FCA to confirm this.

When applying to the regulator for approval for an individual to perform a SMF, firms must submit a Statement of Responsibilities indicating the Senior Manager's responsibilities. Please see the paragraphs below for more information.

Senior managers must be allocated responsibilities

One of the main themes of the SMCR is the increased accountability of individual Senior Managers. As part of this, firms are required to maintain several documents which highlight how responsibilities are allocated amongst senior personnel.

Statement of Responsibilities

Type 1: Limited Scope	Type 2: Core	Type 3: Enhanced
✓	✓	✓

Firms will need to maintain a Statement of Responsibilities for each Senior Manager and submit this when seeking approval for that Senior Manager. The Statement of Responsibilities is an important part of the SMCR framework and requires careful consideration.

The Statement of Responsibilities should identify the areas of a relevant firm's regulated activities for which the Senior Manager is responsible. We would also expect the regulators to consider whether the responsibilities listed in it are appropriately allocated to the relevant Senior Manager. Firms will need to consider issues such as whether the person to whom the responsibility is allocated is sufficiently senior.

Prescribed Responsibilities

Type 1: Limited Scope	Type 2: Core	Type 3: Enhanced
✗	✓	✓

Most firms will be required to allocate certain prescribed responsibilities amongst its Senior Managers. Each Statement of Responsibilities would need to make clear which of these responsibilities have been allocated to the relevant Senior Manager. Please see the Annex of this note for a list of the current prescribed responsibilities.



Responsibilities Map and the Overall Responsibility requirement

Type 1: Limited Scope	Type 2: Core	Type 3: Enhanced
✘	✘	✔

Type 3: Enhanced firms will be subject to additional requirements under the SMCR. In particular, such firms will be required to produce a Responsibilities Map as part of the regime. The purpose of the Responsibilities Map is to provide an overview of the roles of Senior Managers and other senior personnel at a firm, and give a clear indication of their responsibilities. The map will also show whether there are any gaps in accountability, and indicate whether the firm has a clear organisational structure.

The Responsibilities Map must list all Senior Managers and other senior personnel and specify their responsibilities. The Responsibilities Map must also contain detail on the firm's governance arrangements. For example, it should provide details of reporting lines and show how the firm is managed and the structure of decision-making.

Type 3: Enhanced firms will also be subject to an "overall responsibility" requirement. This means that they will need to ensure that every activity, business area and management function in the firm has a Senior Manager with overall responsibility for it. The purpose of this is to prevent unclear allocation of responsibilities which might result in particular issues or activities falling through the cracks.

In our experience, ensuring compliance with these requirements can be particularly complex given the number of different factors that must be considered.

Senior managers have a duty of responsibility

Type 1: Limited Scope	Type 2: Core	Type 3: Enhanced
✔	✔	✔

Under the SMCR, each Senior Manager will have a duty of responsibility in relation to areas within his/her responsibility (as identified in the Statement of Responsibilities). This means that:

- if the firm has breached a regulatory requirement in an area within a Senior Manager's responsibility; and
- the Senior Manager has failed to take such steps as a person in the Senior Manager's position could reasonably be expected to take to avoid the contravention occurring or continuing, the FCA will be able to take action against that Senior Manager.

One positive aspect to note is that the criminal offence of recklessly causing a financial institution to fail, which currently applies to banks under the SMCR, will not apply to other types of firm when the SMCR is extended.



Other key employees must be certified

Type 1:
Limited Scope



Type 2:
Core



Type 3:
Enhanced



SMCR requires firms to certify persons who are not performing Senior Management Functions, but who are employed in positions where they could pose a risk of significant harm to the firm or any of its customers. The FCA has specified a list of the certification functions that will be caught. These include the following persons and functions:



Significant management functions



Proprietary traders



CASS oversight function



Functions subject to qualification requirements



Anyone who manages another certified person



Material risk takers



Algorithmic trading



The client dealing function

The firm must prepare a certificate indicating that it is satisfied that the person is fit and proper for the relevant role. The certificate must also set out the aspects of the affairs of the firm in which the person will be involved in performing the function. When assessing fitness and propriety, the firm must consider the person's qualifications, the training the person has had or is receiving, and the person's competence and personal characteristics. The certificate is only valid for 12 months, which means that individuals must be re-assessed and re-certified on a yearly basis.

While the extension of the SMCR to all FCA-authorised firms may mean that, in some cases, fewer people at these firms may need to be formally approved by a regulator, the Certification Regime is likely to cover all current Approved Persons and may also cover individuals who are not currently Approved Persons.

Firms will need to consider which of their employees will require certification, and update their compliance policies and HR processes to take account of the certification process. The certification/assessment processes could be built into firms' annual staff appraisal processes.

Employees are subject to new conduct rules

Type 1:
Limited Scope



Type 2:
Core



Type 3:
Enhanced



The regime will involve the introduction of new Conduct Rules for individual staff. FCA-authorised firms which become subject to new Conduct Rules may need to make updates to compliance processes, employment policies and/or employment contracts to reflect this. Firms will also need to train staff who are subject to the Conduct Rules, and notify the FCA in the event of breaches of these rules and related disciplinary action. This will require changes to be made to internal processes to ensure compliance.

The new FCA conduct rules will replace the existing Conduct Rules in APER in the FCA Handbook. The new Conduct Rules will apply very widely to all employees except those performing ancillary tasks, such as receptionists, post room staff, security guards and cleaners. The rules will also apply to non-executive directors.

The FCA rules contain a set of Individual Conduct Rules that apply to all in-scope employees, and a set of conduct rules that apply only to Senior Managers. The following rules will apply to all in-scope employees:

- 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.

The following, additional rules will apply to Senior Managers.

- You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
- 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.
- 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.

New rules on regulatory references

Type 1:
Limited Scope



Type 2:
Core



Type 3:
Enhanced



Firms seeking to appoint a Senior Manager, non-executive director or certified person must request a regulatory reference from the person's past employer(s). This may require changes to a firm's hiring processes. A Senior Manager will need to be made accountable for the firm's regulatory reference obligations, as this is one of the prescribed responsibilities (see above).

The key elements of the regulatory references rules are as follows:

- Firms must request a reference covering the person's employment for the previous six years. This applies even if the person's previous employers were not authorised firms.
- Ideally, the reference should be obtained before an application for approval is made (for a Senior Manager), or before the person is certified in line with the Certification Regime.
- There are also requirements for authorised firms to provide references on request. Regulatory references should focus on regulatory matters only, such as issues relevant to fitness and propriety or confirmed misconduct. The regulators have provided a list of information that should be provided.
- Regulatory references must be provided in a specific template, and there is an obligation to update regulatory references issued in the prior six years if the firm becomes aware of information requiring the reference to be updated.

Next steps for firms

The SMCR will introduce a number of substantial changes for firms, and firms should plan to set aside sufficient resource to implement these changes. Firms could consider taking the following next steps to implement the regime.

- Create a project plan tailored for the relevant firm. As not all of the requirements apply to all types of entity, firms should start by confirming the requirements that are relevant to them.
- Complete a mapping exercise to identify any new SMFs and to allocate the new prescribed responsibilities. Identify any certification staff roles within the organisation.
- Develop statements of responsibility documents and (where required) a Responsibilities Map.
- Review the impact of the new regime on internal controls and procedures. In particular, there will be a need to ensure there are procedures to cover:
 - the maintenance of Responsibility Maps (where required);
 - handover arrangements for persons moving into and out of Senior Manager roles (where required);
 - assessment procedures for Senior Managers and Certification Staff; and
 - HR and disciplinary procedures.
- Senior Managers may want to negotiate their individual Statements of Responsibility.
- Senior Managers may also want to establish arrangements to ensure that they are able to obtain assurance regarding the adequacy of the performance of functions falling within the scope of their Statements of Responsibility, given the duty of responsibility (which could lead to changes in arrangements for audit, internal risk reviews, and the production and dissemination of management information).
- Prepare any relevant submissions to the regulator for new SMFs and completing conversion notifications if required.



How we can help

Our team has experience advising a range of authorised entities in this area, including on the extension of the SMCR specifically. We can provide practical guidance on implementation for your firm, and insight into market-standard practices.

We are able to advise on the legal and regulatory implications for firms of the implementation of the extended regime. This includes advice on the interpretation of the new requirements, together with advice on employment law and regulatory enforcement matters. We are also able to assist with project planning, process mapping, design of new internal controls, submissions to the regulators and the preparation of required documentation.

Please contact us if you would like to receive a sample project plan with details of how we can help you implement the regime.

Our financial institutions team

Our cross-border, multidisciplinary team provides the insight you need, wherever you need it.

We work across all major market sectors, including retail and investment banks, insurers, intermediaries, peer to peer lenders, FinTech companies, alternative lenders, asset managers, infrastructure providers, as well as industry bodies and regulators. This means we bring a complete market view to your projects.

We help our clients deal with the increasingly varied and complex challenges presented by the UK and European regulatory bodies. We have acted for all sides (including authorities, governments, investors, and clients), and therefore can see the issues from all perspectives. Strong relationships with local, national, and supranational regulatory bodies mean we can navigate regulations to find solutions or lobby for change where none can be found.

Our team is poised at the cutting edge of the industry and regularly help our clients navigate through the newest and often most complex regulatory developments. Through our thought leadership programme, our industry events and highly regarded industry publications we are providing the industry with some of the most topical information and advice.

Because you work globally, so do we – with teams on the ground in major financial hubs and offices in the emerging economies.



Selected experience

- Advising a firm on their project for the implementation of the upcoming SMCR.
- Providing advice on SMCR as it applies to banks.
- Providing advice to an entity which will become subject to the extended SMCR when it applies.
- Advising various insurers on the projects for the implementation of and on-going compliance with the Senior Insurance Managers Regime. This included advising with all aspects of compliance from formulating and helping update policies and procedures, developing governance maps and statements of responsibility and answering questions on process.
- Advising various financial institutions on Approved Persons issues, including applications for approval, removal of Approved Persons and notifications of Approved Persons-related matters to the UK regulators.
- Advising two large UK retail banking groups on their strategies for responding to the PRA and FCA's consultation on the Senior Managers Regime as it applies to banks.
- Advising the board of a UK bank on UK corporate governance requirements and regulatory requirements applicable to the operation of board arrangements. This included training on the Senior Managers Regime.
- Advising various financial institutions in the UK on the adequacy of their governance arrangements either in advance of, or following, regulatory supervision visits or section 166 skilled persons reviews.
- Advising a wide range of UK financial institutions on issues relating to internal governance arrangements, systems and controls, approved persons, and regulatory authorisations and approvals – this has included, for example, advising on compliance manuals and procedures, board arrangements, committee terms of reference and reporting lines.
- Advising a UK insurer on a review of its entire internal control environment, including the structure of its board, the composition of its governing committees (including Executive Management Committee, Audit Committee and Risk Management Committee) and the effectiveness of its control functions.
- Advising a UK bank on its governance arrangements in response to the adverse findings of an FCA Skilled Person's Report. This included the provision of advice and training to the board on the governance of UK banks, together with training on the impact of the new Senior Managers Regime.
- Advising various financial institutions on the adequacy of their governance arrangements either in advance of, or following, regulatory supervision visits or section 166 skilled persons reviews.
- Advising various clients on the application of and compliance with the Remuneration Codes including advice on which codes apply, the level of compliance required, the application of proportionality, the introduction of new remuneration arrangements and the application of the Code to various overseas group personnel.

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Annex

Senior management functions

The lists below contain the senior management functions which apply to the different categories of firm.

Type 2: Core firms

- SMF1 – CEO
- SMF3 – Executive Director
- SMF27 – Partner
- SMF9 – Chair
- SMF16 – Compliance Oversight
- SMF17 – Money Laundering Function

Type 1: Limited Scope firms

Type 1 firms are subject to fewer senior management functions, depending on the type of limited scope firm they are, one or a combination of the following functions could apply:

- SMF16 – Compliance Oversight
- SMF17 – Money Laundering Function
- SMF29 – Limited Scope Function (only relevant to some Type 1: Limited Scope firms)

Type 3: Enhanced firms

In addition to the senior management functions that apply to Core firms, the following additional functions apply to Enhanced firms:

- SMF2 – Chief Finance Function
- SMF4 – Chief Risk Function
- SMF5 – Head of Internal Audit
- SMF14 – Senior Independent Director
- SMF12 – Chair of the Remuneration Committee
- SMF10 – Chair of the Risk Committee
- SMF11 – Chair of the Audit Committee
- SMF13 – Chair of the Nominations Committee
- SMF24 – Chief Operations Function
- SMF18 – Other Overall Responsibility

Prescribed responsibilities

Please see below a list of some of the prescribed responsibilities which apply to Type 2: Core firms. Type 3: Enhanced firms are subject to additional prescribed responsibilities. Type 1: Limited Scope firms are not subject to any prescribed responsibilities.

- Performance by the firm of its obligations under the Senior Managers Regime, including implementation and oversight
- Performance by the firm of its obligations under the Certification Regime
- Performance by the firm of its obligations in respect of notifications and training of the Conduct Rules
- Responsibility for the firm's policies and procedures for countering the risk that the firm may be used to further financial crime
- Responsibility for the firm's compliance with CASS
- Responsibility for ensuring the governing body is informed of its legal and regulatory obligations
- (For Authorised Fund Managers only) Responsibility for an Authorised Fund Manager's value for money assessments, independent director representation and acting in investors' best interests

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