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ALERT MEMORANDUM

Individual accountability in financial services: extending the Senior Managers & Certification Regime

5 September 2017

In the wake of the financial crisis and a number of high-profile cases involving perceived misconduct by senior individuals in the financial sector, regulatory focus alighted on individual accountability as a means to address perceived cultural and behavioural shortcomings. Continuing the trend, on 26 July 2017, the UK's Financial Conduct Authority (the "**FCA**") published proposals to extend the Senior Managers & Certification Regime (the "**SMCR**") to all FCA-regulated firms.[1]

The proposals build on the existing SMCR that was implemented in the UK in March 2016 for banks and certain other firms regulated by the Prudential Regulation Authority (the "**PRA**"). The SMCR framework aims to incentivise better culture, behaviour and governance within firms by increasing individual accountability and by subjecting a wide range of staff to conduct standards and oversight.

This briefing considers the scope of the new regime, explains how it will apply and discusses some of the implementation challenges that firms will face.

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[1] FCA consultation paper CP17/25: "*Individual Accountability: Extending Senior Managers & Certification Regime to all FCA firms*", dated July 2017.

I. Introduction

Background

The SMCR was created as a response to recommendations by the Parliamentary Commission on Banking Standards (the "**PCBS**"). The PCBS reviewed standards of behaviour in the banking industry during the financial crisis and concluded that senior management "*benefited from an accountability firewall between themselves and individual misconduct*". In response, the PCBS recommended changes to the regulation of senior management to enhance their accountability. The SMCR was implemented for firms regulated by the PRA in March 2016. Shortly before its implementation, the Government confirmed that it would legislate to bring the regime into force for all firms authorised under the UK Financial Services and Markets Act 2000 ("**FSMA**").

Currently, firms that are regulated only by the FCA (*i.e.* solo-regulated firms) are subject to the Approved Persons Regime, which has existed in broadly the same form since 2001. The Approved Persons Regime: (i) mandates that persons performing key senior and customer-facing "controlled functions" obtain prior regulatory approval before commencing their roles; (ii) sets standards for behaviour for those persons holding such controlled functions in the Statements of Principle and an accompanying Code of Practice; and (iii) requires that firms ensure that persons performing controlled functions are "fit and proper".

Section II of this alert provides an overview of the proposed FCA regime, Section III sets out the detail of the Senior Managers Regime, Section IV outlines the Certification Regime, Section V details fitness and propriety requirements, Section VI sets out details on the Conduct Rules, Section VII discusses the implications for firms and Section VIII outlines practical steps for firms to consider.

II. Overview of the Proposed SMCR

Which firms will the proposals affect?

The proposed SMCR will impact every firm that is authorised by the FCA under FSMA, including small firms, those with limited permissions (*e.g.* sole traders and consumer credit firms) and UK branches of foreign firms. The FCA anticipates that the regime will apply to approximately 47,000 firms. As a result, the SMCR will capture a much wider number of individuals than the current Approved Persons Regime.

The FCA has, however, proposed a tiered approach to the application of the SMCR, which will depend on the size of the firms and the activities which it conducts.

What are the key components of the SMCR?

The SMCR replaces the Approved Persons Regime with three "layers" of requirements:

<u>Senior Managers Regime</u>, which will apply to individuals performing certain functions set out in a prescribed list ("**Senior Managers**"). Under the Senior Managers Regime, members of a firm's senior management will require pre-approval from the FCA.

<u>Certification Regime</u>, which will require firms to certify on at least an annual basis the fitness and propriety of employees performing certain roles specified by the FCA that may have a significant impact on customers, the markets or the firm ("**Certified Persons**").

<u>Conduct Rules</u>, which will apply to all employees, except those performing purely ancillary roles specified by the FCA.

When will the SMCR come into effect for solo regulated firms?

The FCA had previously committed to implement the new regime in 2018. The FCA has stated in its consultation paper that it intends to publish a policy statement setting out its final rules in 2018, but has given no indication of when the rules will come into force or whether implementation will be staggered.

Categories of firms under the SMCR

The FCA proposes to place each firm within the scope of the SMCR into one of three categories:

— Core firms: the majority of firms that will be subject to the baseline SMCR requirements. We detail these requirements below in Section III.

— Limited scope firms: firms subject to fewer requirements than "core firms" and will include all firms that currently have a limited application of the Approved Persons Regime.

— Enhanced firms: a small proportion of solo-regulated firms (approximately 350 in number) that will be subject to additional requirements. Firms meeting the criteria for an enhanced firm will automatically be subject to these additional rules. Accordingly, firms which are close to meeting one of the relevant criteria will need to monitor whether and how the criteria apply to them. The FCA has explicitly stated that limited scope firms and authorised branches of European Economic Area ("**EEA**") and non-EEA firms will not be moved into the enhanced regime. A table showing how firms map to the proposed categories is set out in Appendix 1.

Widening of disciplinary powers

The proposals represent a significant widening of the scope of individual accountability within FCA-authorised firms. At present, regulatory jurisdiction over individuals is limited to approved persons. The proposals extend the FCA's power to take disciplinary action to cover all employees of solo regulated firms, subjecting almost all staff to potential personal liability.

III. Senior Managers Regime

What are the key features of the Senior Managers Regime?

The Senior Managers Regime will apply to persons who "*are the most senior people in the firm with the greatest potential to cause harm or impact market integrity*". The Senior Managers Regime requires that certain persons carrying on Senior Manager Functions are pre-approved by the FCA before they can carry out their roles. The pre-approval process will also necessitate changes in how firms assess the suitability of such Senior Managers and will introduce new rules in relation to regulatory references and criminal record checks, on top of the continuing requirement for a Senior Manager to be fit and proper.

In addition, the Senior Managers Regime requires that Senior Managers must each have a Statement of Responsibilities, which may include certain "Prescribed Responsibilities", and subjects them to a "Duty of Responsibility" under FSMA. Senior Managers will also be subject to the fit and proper requirement under the SMCR (see further below in Section V: Fitness and Propriety).

Summary Diagram – The Senior Managers & Certification Regime

Senior Manager Conduct Rules

Senior Managers Regime

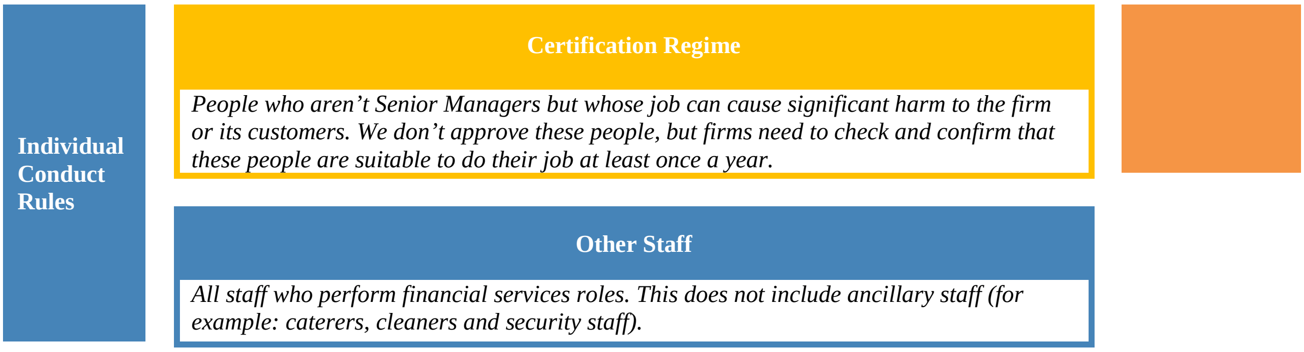
The most senior people in firms. Anyone who performs a Senior Management Function needs to be approved by us.
Core requirements:

Senior Management Functions	**Duty of Responsibility**	**Statement of Responsibilities**	**Criminal Records Checks**	**Prescribed Responsibilities *(Limited Scope Firms don't need to do this)***

Extra requirements that only enhanced firms need to meet

Additional Senior Management Functions	***Additional Prescribed Responsibilities***	***Responsibilities Maps***	***Handover Procedures***	***Overall Responsibility***

Fit and Proper Requirements (including Regulatory References)



Source, page 15 of FCA CP17/25

Application

<u>Territorial Scope</u>

There is no territorial limitation on the scope of the Senior Managers Regime, which will apply to anyone performing a Senior Manager role regardless of whether they are based in the UK or overseas (albeit that the Senior Manager Functions requiring approval are limited in the case of branches to the UK branch senior manager and money laundering reporting officer). This is consistent with previous guidance from the FCA which indicates that the regime will apply to Senior Managers without any territorial limitation, wherever they are based.[2]

<u>Senior Manager Functions</u>

In its amended SUP handbook, the FCA has proposed a list of Senior Manager Functions that will require pre-approval from the FCA. Pre-approval is only required where one of the specified Senior Manager Functions is carried out, as is currently the case under the Approved Persons Regime, so some proposed Senior Manager Functions may be superfluous depending on the type of firm and the nature of its activities.

Notably, the FCA has stated that the regime will not apply to non-executive directors. Therefore, those non-executive directors currently approved under the Approved Persons Regime will not require approval under the SMCR. They will, however, be subject to the Conduct Rules (see further below).

Appendix 2 sets out the full set of proposed Senior Manager Functions for FCA solo-regulated firms, and their application to the different types of firms (limited scope, core and enhanced).

What is the Statement of Responsibilities?

Firms will be required to submit a Statement of Responsibilities when applying for approval for a Senior Manager Function holder, setting out the aspects of the affairs of the firm concerned for which the holder will have managerial responsibility.

Statements of Responsibilities must be kept up to date and re-submitted whenever there is a significant change to a Senior Manager's responsibilities. The FCA has proposed guidance on the meaning of such a "significant change", which would include, for example, a change resulting from a variation of approval and a change in the job role.

The Statement of Responsibilities will be the reference point for the FCA to determine the nature of a Senior Manager's role, the extent of that Senior Manager's responsibility and the manner in which the Senior Manager's role operates within the governance and management structure of the firm. It must be consistent with the Responsibilities Map, where relevant (see further below), and must be a complete document in itself.

[2] Previous FCA guidance is contained in feedback statement 15/3: "<u>Strengthening accountability in banking: UK branches of foreign banks</u>", dated August 2015. In section 2.7, the FCA states "*where an individual is responsible for implementing [a firm's] strategy in a UK branch, <u>wherever they are based</u>, they are likely to require approval*" [emphasis added]. See also section 2.25 of the feedback statement where the FCA states that "*for activities or functions that come under the management of the branch's governing body … local responsibility [will be] defined in relation to the branch's governing body rather than the firm's ultimate board.*"

The Statement of Responsibilities must be submitted in a template format, the form of which will be subject to a further consultation later in 2017.

What is the Duty of Responsibility?

Under the Senior Managers Regime, all Senior Managers will have a Duty of Responsibility so that, having identified which Senior Manager is responsible for a failure or breach of requirement, the FCA can hold the individual accountable if they did not take "reasonable steps" to prevent or stop the breach. The burden of proof will lie with the FCA to demonstrate that the Senior Manager did not take the steps a person in their position could reasonably be expected to take to avoid the firm's breach occurring. Importantly, in bringing enforcement action against a Senior Manager, the FCA will consider the individual's Statement of Responsibility to determine the extent of their responsibility. The Duty of Responsibility already exists under the existing SMCR implemented by the PRA and is expected to apply in the same manner to FCA solo-regulated firms.

What are the Prescribed Responsibilities?

In addition to the responsibilities that are inherent in the Senior Manager's role, core firms and enhanced firms must allocate specific responsibilities to a Senior Manager, known as "Prescribed Responsibilities". The requirement to allocate Prescribed Responsibilities does not apply to limited scope firms, but only to core and enhanced firms. In addition, enhanced firms also have further specific Prescribed Responsibilities (discussed further in "What additional requirements are required for enhanced firms under the Senior Managers Regime?").

The Prescribed Responsibilities must be allocated to the appropriate Senior Manager, who should be the most senior person responsible for the business area responsibility and must be reflected in an appropriate manner in the Statement of Responsibilities for the Senior Manager (including where the Prescribed Responsibility is shared with another Senior Manager).

The core Prescribed Responsibilities are set out in Appendix 4.

Can Prescribed Responsibilities be held jointly?

The proposals accommodate the joint sharing or division of Prescribed Responsibilities between two or more staff. Where Prescribed Responsibilities are shared or divided, there will need to be a clear delineation of responsibilities in the Statement of Responsibility for each Senior Manager (and, if relevant, in the Responsibility Map). The regime arguably disincentivises the sharing of responsibilities given that staff can be held accountable for acts or omissions of another Senior Manager where responsibilities are held jointly.

What additional requirements are required for enhanced firms under the Senior Managers Regime?

<u>Additional Senior Manager Functions</u>

The FCA has proposed six additional functions to cover a number of specific roles that are relevant to enhanced firms. The table of Senior Manager Functions in Appendix 2 reflects all the functions that will apply to enhanced firms, both core and additional.

<u>Additional Prescribed Responsibilities</u>

In addition to the core Prescribed Responsibilities, enhanced firms will also be required to apply additional Prescribed Responsibilities to Senior Managers which are set out in Appendix 4.

<u>Overall Responsibility</u>

Enhanced firms will be subject to an "Overall Responsibility" requirement that necessitates the identification and allocation of every activity, business area and management function to a Senior Manager, who will retain overall responsibility for it. Enhanced firms will be required to report to their governing body on the Overall Responsibility requirement. The purpose of this requirement is to ensure that there are no gaps in accountability in the management of the firm. The Overall Responsibility rule applies both to a firm's regulated and unregulated financial services activities and will include activities carried out from a branch overseas and transactions taking place overseas.

The person who will retain overall responsibility for each area does not need to have day-to-day management control of that function, but should be the most senior person responsible for managing the overall area. If the firm identifies that an individual who is not already a Senior Manager should be allocated overall responsibility for a particular area, they will need to be approved to perform SMF18 – Other Overall Responsibility.

Responsibility maps

The FCA is proposing to introduce a "Responsibility Map" for enhanced firms. This will be a single document that sets out the relevant firm's management and governance arrangements and the manner in which these are allocated. It is intended to capture the collective view of the allocation of responsibilities across the firm.

Handover Procedures

Consistent with the existing framework, the consultation proposes that enhanced firms will need to implement handover procedures to ensure that a person who is becoming a Senior Manager has all the information and material that they could reasonably expect to do their job.

IV. Certification Regime

The SMCR will introduce a Certification Regime that is similar to the one currently in force for banks. The proposals require firms to certify employees as fit and proper where they perform a "significant harm function". A significant harm function is "*one that requires the person performing it to be involved in one or more aspects of the firm's affairs, so far as relating to a regulated activity, and those aspects involve, or might involve, a risk of significant harm to the firm or any of its customers*". Firms will be required to renew certifications on an annual basis.

Application

'Employees' only

The Certification Regime applies only with respect to "employees" of the firm. This is defined in FSMA to include employees and any person who "*personally provides, or is under an obligation personally to provide, services*" to the firm and "*is subject to (or to the right of) supervision, direction or control*" by the firm as to the manner in which those services are provided.[3]

The definition will capture secondees to a firm, but generally not independent contractors providing services under a contract for services. For firms operating through multiple legal entities, it will be necessary to assess whether staff performing roles under inter-affiliate services arrangements are caught; where they are not, there may be senior management pressure to change the service model to bring staff within the scope of the regime.

Territorial scope

For UK firms, the regime will be limited to persons performing a certification function who are either based in the UK or who deal with UK clients (if the person performing the certified function is based outside of the UK). However, as an exception to this territorial limitation, an individual who is a "material risk taker" under the FCA's Remuneration Codes will be subject to the Certification Regime, even where the individual is based outside the UK and does not deal with UK clients.

For incoming branches of both EEA firms and non-EEA firms, the Certification Regime will be limited to staff based in the UK and will not extend to staff based outside of the UK, even if they deal with a UK client.

Functions requiring certification

The FCA has proposed the following as certification functions:

— Significant management functions (currently covered by CF29);

— Proprietary traders (currently covered by CF29);

— CASS oversight functions (currently covered by CF10a);

— Functions subject to qualification requirements (*e.g.* mortgage advisers, retail investment advisers and pension transfer specialists);

— Client dealing functions (expanded from the current CF30 function to cover any person dealing with clients);

— Algorithmic traders;

[3] Section 63E(9) FSMA.

— Material risk takers (staff subject to Remuneration Codes); and

— Anyone who supervises or manages a person carrying out one of the certification functions listed above.

Not all firms will have staff who perform each of these functions. Certain of these functions are broadly defined. For example, the significant management certification function will be a "catch-all" function that applies to a person who has significant responsibility for a significant business unit. For this function, firms will be required to consider each business unit (including internal and non-revenue generating business units), and assess their size and significance to the firm's business in the UK, the business unit's risk profile and use of firm capital and the number of employees and customers attributable to that unit.

The proposed regime will place the primary duty on firms, rather than regulators, to take responsibility for ensuring the fitness and propriety of employees. The FCA will not carry out these checks, as it presently does under the Approved Persons Regime. Certified Persons will also not appear on the FCA Register.

The Certification Regime will reduce the number of FCA-approved employees within a firm to a substantial extent, as most individuals holding customer-facing roles will no longer require regulatory approval (*e.g.* individuals who currently hold the CF29 and CF10a functions, which will not be Senior Manager Functions under the SMCR). As for the Senior Manager Functions, non-executive directors will also fall outside the scope of the regime. Senior Managers that carry on certification functions closely linked to their role as a Senior Manager will not need to be separately certified.

Certified Persons will also be subject to the fit and proper requirement under the SMCR (see further below in Section V: Fitness and Propriety).

V. Fitness and Propriety

The requirement to ensure that certain persons are fit and proper to carry out particular activities is not a new concept and, prior to March 2016, both the FCA and the PRA operated a common fitness and propriety framework that applied to all Approved Persons in regulated firms. Consequently, when the PRA's SMCR was introduced, it did not make fundamental changes to its existing fitness and propriety standards. The FCA proposes taking the same approach. The SMCR's fit and proper requirement will apply to Senior Managers, Certified Persons and non-executive directors.

A key difference between the fit and proper requirement under the SMCR and the Approved Persons Regime is that the SMCR introduces more onerous requirements in relation to the evidence that relevant firms should collect as part of their process of assessing whether candidates meet this standard. The regime effectively outsources the assessment of fitness and propriety from the FCA to firms.

Factors such as the qualifications, training, competence and personal characteristics of employees, as set out in the FCA's existing rules, will continue to be relevant, and firms will be required to consider them when assessing a Senior Manager or Certified Person under the SMCR. Once someone is a Senior Manager or Certified Person, firms will need to assess their fitness and propriety on an ongoing basis and at least once a year.

<u>Criminal record checks for Senior Managers</u>

The current approval process requires that candidates answer a series of questions about their personal character and declare whether they have a criminal record. This requirement will continue for Senior Managers.

However, firms will be required to undertake their own criminal record check (involving registration with the Disclosure and Barring Service and equivalent agencies in Scotland and Northern Ireland) as part of each application for a Senior Manager Function. This requirement will also apply to non-executive directors where a fitness requirement already applies to them, but is not mandatory for Certified Persons.

For candidates who have spent considerable time outside of the UK, the FCA recommends that firms should consider undertaking an equivalent check with the appropriate overseas bodies, where possible.

Regulatory references for Senior Managers, Certified Persons and non-executive directors

Under the forthcoming regime, firms are required to request references and, where requested, provide references, covering the previous six years of employment for any Senior Manager Function, Certified Person and non-executive director appointment.

- Firms will also need to disclose any facts that led to the previous employer concluding that the candidate breached a Conduct Rule (see below), details of any disciplinary action and any findings that a person was not fit and proper.
- For any information relating to serious misconduct, there is no time frame for disclosure on information relevant to assessing whether a candidate is fit and proper.
- Firms are prohibited from entering into arrangements that conflict with their disclosure obligations, *e.g.* non-disclosure agreements.
- Records relating to disciplinary and fit and proper findings must be retained for six years.

VI. Conduct Rules

One of the biggest changes under the SMCR is the introduction of Conduct Rules, which will apply to almost every person working in financial services. The Conduct Rules are high level and reflect the core standards expected of staff.

Application

'Employees' only

As with the Certification Regime, the Conduct Rules apply only with respect to "employees" of the firm, as defined broadly. The definition will capture secondees to a firm, but generally not independent contractors providing services under a contract for services. For firms operating through multiple legal entities, it will be necessary to assess whether staff performing roles under inter-affiliate services arrangements are caught.

Roles within scope

The scope of the Conduct Rules is very wide; all staff other than those who carry out 'ancillary roles' will be subject to the core Conduct Rules. Persons carrying out ancillary roles are specified in an exhaustive list and are: receptionists, switchboard operators, post room 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 (*i.e.* helpdesk) and human resources administrators/processors.

Conduct Rules

The proposed Conduct Rules are drafted at a high level of generality, reflecting the scope of firms that they will apply to. They are divided into:

- First tier: individual Conduct Rules; and
- Second tier: Senior Manager Conduct Rules.

Appendix 5 sets out the Conduct Rules in full.

The Conduct Rules mirror the existing Statements of Principle for Approved Persons in some respects. However, two of the Conduct Rules merit particular comment:

- Rule 4 requires individuals to pay due regard to the interests of customers and treat them fairly. There is no such requirement on individuals under the existing regime. This new requirement addresses concerns raised in certain high profile customer misselling disciplinary cases, including those involving products such as payment protection insurance and interest rate hedging products. In these cases, individual accountability was not straightforward to identify, and therefore this rule addresses a lacuna in the existing regime.
- SC3, requiring Senior Managers to oversee the discharge of delegated responsibility and ensure that it is delegated to an appropriate effecting person, has no equivalent in the current regime. This rule is consistent with the regulators' desire to promote diligent oversight by senior management and should be read in the context of the other requirements under the Senior Managers Regime, such as the Duty of

Responsibility and ensuring adequate allocation of Prescribed Responsibilities.

The FCA draft Handbook text gives more detailed guidance on the types of conduct that would breach the rules. This approach has some similarities to the existing regime, where the high-level Statements of Principle for Approved Persons are supplemented by the guidance and examples in APER 4.

Firms will be required to train employees subject to the Conduct Rules on the manner in which the rules apply to them and must notify the FCA when they become aware that, or suspect that, a person has breached the Conduct Rules. Firms will also be required to notify the FCA if they take disciplinary action against a person in relation to a breach of the Conduct Rules. The time frame for the notification obligation is within seven business days of the firm becoming aware of the matter for Senior Managers and on an annual basis for all other individuals.

It is worth noting that the Conduct Rules apply to a firm's regulated and unregulated financial services activities, including activities carried on in connection with a regulated activity. The scope of the proposed FCA regime is, however, narrower than those applied within the PRA's SMCR, where the Conduct Rules apply to everything done on behalf of a relevant firm.

VII. How will the SMCR affect firms?

The introduction of the SMCR for the bank sector was initially a matter of some controversy for firms. This was largely a matter of the rather hostile rhetoric at the time around threats of criminalising negligent bankers, and the proposal that there be a reverse burden of proof for disciplinary action against senior management. In practice, SMCR implementation has not been particularly disruptive, helped by the fact that, to date, there has been no enforcement action taken by the PRA or FCA against individuals under the new regime, although the SMCR is still in its early days.

For larger banks, the introduction of the regime requirements drove firms to undertake reviews of their governance structures and the roles and responsibilities of senior management, including decision-making processes, collective versus individual responsibilities, record-keeping around decisions and the upward flow of management information to support senior managerial oversight. Larger solo-regulated firms (chiefly the enhanced firms) may want to consider similar action. The key lesson from the implementation of the existing regime is to balance enhanced accountability with the need to run the business of the firm efficiently on a business as usual basis.

The main source of possible tension associated with the regime is the potential for conflicts to arise between senior management and the firm itself. This makes it important that firms are responsive to the needs of Senior Managers and ensures that Senior Managers are sufficiently closely involved to understand and support any changes to the firm's organisational structure, governance and procedures resulting from the introduction of the regime. Some of the other pressure points of the proposed regime include:

— Allocation of responsibility generally: for larger firms, implementation is likely to involve a review of the overall governance structure of the organisation to ensure that there is clarity of "ownership" among senior management for all business lines, units and support functions.

— Matching accountability with oversight: the Statement of Responsibilities will set the parameters of the activities of the firm for which a Senior Manager is accountable. For enhanced firms in particular, the requirement to map responsibilities may cause a reappraisal of reporting lines, to ensure that each individual Senior Manager's accountability is matched by their oversight.

— Co-heads, and shared (or divided) responsibilities: where a firm has co-heads, or co-heads of a significant business unit or function, the accountability rules will apply to the co-heads jointly. Whilst the draft rules permit the splitting of responsibilities to accommodate the allocation of responsibilities across more than one person, there is an inherent risk of being found jointly accountable. Individuals with co-head roles will need to consider their appetite for the change to their regulatory risk profile.

— General Counsel role: in spite of discussion of the inclusion of the General Counsel role within the scope of the regime, the proposals do not include the General Counsel role within the scope of the Senior Managers or Certification Regimes. Where the General Counsel performs other roles within the scope of the regime, however, he or she will be subject to the regime; this may incentivise changes to the General Counsel role (*e.g.* where firms have a common head of legal and compliance).

— Management information: the regime incentivises Senior Managers to be better informed as to issues of regulatory interest. Consideration may need to be given to Senior Managers' expectations as to the volume and coverage of management information.

— Documenting decision-making: in principle, the Duty of Responsibility might be expected to cause Senior Managers to reassess how decisions are made and documented. In practice, in the banking sector there has been relatively little change in these areas.

— Handovers: the handover requirements for enhanced firms will drive informational needs for incoming Senior Managers. They also arguably incentivise a degree of 'kitchen sinking' by incoming managers, which may need to be managed.

— Outsourcings: because the responsibilities of Senior Managers extend to outsourced service provision (on the basis that firms cannot outsource their supervisory responsibilities) it may be appropriate to revisit outsourcings of critical or important functions to ensure that the controls and oversight by the firm are appropriate to enable responsible Senior Managers to discharge their responsibilities under the new regime.

VIII. What should firms be doing?

From our experience of assisting banks with the earlier implementation exercise, implementation is likely to take in the order of nine months for the more complex firms. It is unhelpful that the consultation does not indicate when the final rules will come into effect: firms should encourage the FCA to defer implementation given the weight of other regulatory initiatives in play (including Brexit). Firms may also wish to engage with the FCA on other areas, although, given the similarity of the regime to the SMCR for banks, there is likely to be limited change to the substance of the regime. Other particular areas which appear to merit further consideration are:

— Proportionality of the regime, which is likely to extend to the boundary between enhanced and core, and between core and limited scope, firms and to the substantive obligations imposed on each category.

— Scope of the Certification Regime, in particular its application to all staff subject to qualification requirements (regardless of whether their role involves the risk of significant harm).

— Inclusion of the treating customers fairly requirement within the Code, which encourages staff to second-guess the firms' own regulatory obligations.

In due course, firms will need to prepare implementation plans – for all but the largest firms it is likely to be appropriate to await the final rules before doing so. We have appended a list of the implementation steps firms will need to run through once the final contours of the regime are known at Appendix 3.

Timeline

The FCA's SMCR consultation closes on 3 November 2017, and responses can be sent in written or email form or in an online response form. It is expected that finalised rules will be published in a policy statement in Q2 2018. A further separate consultation paper on operational aspects of the new regime (*e.g.* forms, templates, how to minimize the need for new approval for persons who are already Approved Persons and seek to have a Senior Management Function, *etc.*) is expected later in 2017.

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Appendix 1: Categories of firms under FCA regime

<table>
<tr><th>Limited scope firm</th><th>Core firm</th><th>Enhanced firm</th></tr>
<tr><td>Limited permission consumer credit firms</td><td rowspan="8">Any solo-regulated firm that does not fall within the category of either an enhanced firm or limited scope firm</td><td>Significant IFPRU firm[4]</td></tr>
<tr><td>Sole traders with no employees</td><td>CASS large firm</td></tr>
<tr><td>Authorised professional firms whose only regulated activities are non-mainstream regulated activities</td><td>Firms with £50 billion or more (at any time in the previous 3 years) of assets under management</td></tr>
<tr><td>Oil market participants</td><td>Firms with a current total intermediary regulated business revenue of £35 million or more per annum</td></tr>
<tr><td>Service companies</td><td>Firms with annual regulated revenue generated by consumer credit lending of £100 million or more</td></tr>
<tr><td>Energy market participants</td><td rowspan="3">Mortgage lenders (not banks) with 10,000 or more regulated mortgages outstanding</td></tr>
<tr><td>Subsidiaries of local authorities or registered social landlords</td></tr>
<tr><td>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</td></tr>
</table>

[4] A significant IFPRU firm is defined in 1.2.3 of the IFPRU as a firm that meets, at any time, at least one of the following conditions: (1) its total assets exceeds £530 million; (2) its total liabilities exceeds £380 million; (3) the annual fees and commission income it receives in relation to the regulated activities it carries on exceeds £160 million in the 12-month period immediately preceding the date that the firm carries out its assessment of whether it is a significant IFPRU firm; (4) the client money it receives or holds exceeds £425 million; and (5) the assets belonging to its clients that it holds in the course of, or connected with, its regulated activities exceeds £7.8 billion.

Appendix 2: Application of Senior Manager Functions to different categories of firms

Key	
	Function required
	Function may not apply automatically
	Function does not apply

Function number	**Function description**	**Limited scope firm**	**Core firm**			**Enhanced firm**
			UK	**EEA branch**	**Non-EEA branch**	
SMF1	Chief executive					
SMF2	Chief finance officer					
SMF3	Executive director					
SMF4	Chief risk officer					
SMF5	Head of internal audit					
SMF7	Group entity senior manager					
SMF9	Chairperson					
SMF10	Chair of risk committee					
SMF11	Chair of audit committee					
SMF12	Chair of remuneration committee					
SMF13	Chair of nomination committee					
SMF14	Senior independent director					
SMF16	Compliance oversight					
SMF17	Money laundering reporting officer					
SMF18	Other overall responsibility function					
SMF19	Head of third country branch					
SMF21	EEA branch senior manager					
SMF24	Chief operations function					
SMF27	Partner[5]					
SMF29	Limited scope function					

[5] Note that not all of the partners of a partnership will fall within this category. Where a partner has no role in the management of the business, he/she will not be within SMF27.

Appendix 3: Implementation Steps

IMPLEMENTATION STEPS	
Categorisation	Identify category of firm
Senior Managers	Identify Senior Managers, ensuring all relevant business areas are covered and identifying shared responsibilities
	Allocate Prescribed Responsibilities to Senior Managers
	Create a Responsibilities Map showing allocation of Prescribed Responsibilities
	If an enhanced firm, ensure the Overall Responsibility requirement can be met and that there are no gaps in identifying all activities, business areas and management functions to a Senior Manager
	Agree the remit of responsibilities with Senior Managers and ensure Statements of Responsibilities are drafted to adequately reflect the Prescribed Responsibilities of each Senior Manager
	Submit Senior Manager Function applications to FCA for pre-approval where no grandfathering is available
	Make relevant adjustments to governance frameworks and terms of reference board/committees
	Ensure process is established for carrying out independent criminal record checks and obtaining regulatory references
	Ensure Senior Managers are trained on their responsibilities and the specific Senior Manager Conduct Rules
	Establish processes for ensuring staff remain fit and proper on an ongoing basis
Certified Persons	Identify Certified Persons and material risk takers, ensuring all relevant business areas are covered
	Identify managers and supervisors of Certified Persons
	Ensure process is established for obtaining regulatory references
	Create annual certification processes
	Establish processes for ensuring staff remain fit and proper on an ongoing basis
Conduct Rules	Identify any ancillary staff not subject to Conduct Rules
	Amend contracts of employment and ensure adequate training on Conduct Rules
Other	Review and amend internal policies (*e.g.* staff handbook, escalation policies, code of conduct, disciplinary policies, compliance handbook, regulator notifications, *etc.*)
	Amend employment contracts, if necessary, and update employment contract templates for future use
	Develop training materials, conduct training on new SMCR and obtain relevant attestations / confirmations
	Ensure compliance procedures are in place for annual training and maintaining attestations and other record-keeping obligations

Appendix 4: Prescribed Responsibilities

Core Prescribed Responsibilities

	Description
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 training 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 governing body is informed of its legal and regulatory obligations
7	Responsibility for an authorised fund manager’s value for money assessments, independent director representation and acting in investors’ best interests (applies to UCITS managers only)

Additional Prescribed Responsibilities

	Description
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
10	Safeguarding and overseeing the independence and performance of the compliance function
11	Safeguarding and overseeing the independence and performance of the risk function
12	If the firm outsources its internal audit function, taking reasonable steps to ensure that every person involved in the performance of the service is independent from the persons who perform external audits, including: — the supervision and management of the work of outsourced internal auditors; and — the 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

Appendix 5: Conduct Rules

CONDUCT RULES	
First tier: individual Conduct Rules	
Rule 1	You must act with integrity
Rule 2	You must act with due skill, care and diligence
Rule 3	You must be open and cooperative with the FCA, the PRA and other regulators
Rule 4	You must pay due regard to the interests of customers and treat them fairly
Rule 5	You must observe proper standards of market conduct
Second tier: Senior Manager Conduct Rules	
SC1	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively
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
SM3	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
SM4	You must disclose appropriately any information which the FCA or PRA would reasonably expect notice

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