



Briefing

Financial Regulation Horizons

The Senior Managers and Certification Regimes

A new framework for personal accountability – employment aspects

The Senior Managers and Certification Regimes are the cornerstones of the regulators' drive towards increased personal accountability in the financial services sector. The new regimes, which took effect from 7 March 2016, currently apply to all PRA-regulated banks, building societies, credit unions and investment firms. The operation of the new regimes will be watched with interest by other firms in the sector as with effect from 2018 it is likely that the framework will be rolled out on a wider basis. This could lead to interdealer brokers, hedge funds and asset managers coming within the scope of the new regimes.

The changes are driven by the acknowledgment of a key problem with the approved persons regime, which is that it has been exceptionally difficult to identify individual responsibility for regulatory failings in large organisations where delegation of decision-making responsibilities is commonplace. At the core of the new Senior Managers Regime (SMR) is the ability to make it easier for the regulators to hold individual Senior Managers accountable for regulatory failings within their area of responsibility.

There are three aspects to the new framework:

Senior Managers Regime

The SMR will apply to those senior individuals within firms who hold senior management functions. Senior management functions are performed by those holding ultimate responsibility for core functions such as leadership, finance and risk. These will be members of the board of directors and, in bigger, more complex organisations, certain executive committee members. The primary obligations under the SMR will therefore fall on a narrower group of persons than under the old approved persons regime.

Individuals must seek pre-approval from the FCA or PRA before they can hold senior management functions. Applications to the regulator must be accompanied by a 'statement of responsibility'. This document records the areas for which a senior manager is personally responsible. It is a 'live' document and must therefore be updated and resubmitted where an individual's responsibilities change significantly.

Firms must also prepare a larger 'management responsibilities map' which allocates regulatory responsibilities between relevant Senior Managers within an authorised firm.

The regulators will be able to take action if an individual is shown to have failed to have taken reasonable steps to prevent a regulatory breach within his or her area of responsibility.

Certification Regime

The Certification Regime applies to individuals who perform 'significant harm functions'. These are individuals who in performing their duties are involved in aspects of a firm's regulatory activities that could involve a risk of significant harm to the firm or its customers.

These individuals are not pre-approved by the regulator but are certified by the relevant firm on an annual basis as meeting the necessary standards of fitness and propriety.

Firms subject to the Certification Regime have until 7 March 2017 to have the relevant certificates in place.

Conduct Rules

The new framework also introduces a new set of Conduct Rules, which are high level standards which apply to all staff who work in relevant firms. The only limited exclusion is for certain ancillary functions such as catering or security and other functions not connected with a firm's regulated activities. These Conduct Rules have very wide application and for many individuals this will be the first time they have been directly regulated (and at risk of personal enforcement action) by the FCA and PRA. There are five core conduct rules requiring individuals to:

- Act with integrity
- Act with due skill, care and diligence
- To be open and cooperative with the regulators
- Treat customers fairly
- Observe proper standards of market conduct

The Conduct Rules also include an additional set of requirements which apply to Senior Managers only.

The rules are already in force for Senior Managers and those subject to the Certification Regime. Firms have until March 2017 to prepare for the application of rules to the wider pool of staff.

Practical issues

Firms are already grappling with a number of difficult practical issues.

- There is considerable uncertainty as to how a Senior Manager will be able to demonstrate to the regulator's satisfaction that he or she took reasonable steps to prevent regulatory breaches. This raises the possibility of managers taking a defensive approach to corporate decision-making. It is likely that board minutes will also be subject to much closer scrutiny than was previously the case.
- Senior Managers will demand a higher quality of management information as this will form a key part of the supporting evidence for their decision-making.
- Firms must be ready to negotiate handover of responsibilities when Senior Managers exit the firm. There is the possibility for this handover to become contentious where exits arise from concerns over the Senior Manager's conduct or performance.
- Employment contracts for Senior Managers and those subject to the Certification Regime will need to be amended in light of the new rules.
- Disciplinary action (including suspensions and warnings as well as dismissals) will need to be reported to the regulator where this arises from a breach of the Conduct Rules. Firms will need to ensure that there is mechanism in place for doing this and will need to consider carefully the implications of disciplinary action.
- Firms will need to prepare for the application of the Conduct Rules to all staff in 2017. It is likely that HR policies will need to be reviewed and updated and staff will need to be trained in the requirements of the new regime.
- Individuals performing in-house legal roles should await the outcome of the FCA's consultation on whether the head of legal role would be brought within the scope of SMR. http://www.burges-salmon.com/Sectors/financial_services/Investment%20Funds/News/14712.aspx

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