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COMMENTARY

UK Senior Managers Regime to Extend to All FSMA-Authorised Firms

On 15 October 2015, HM Treasury published a policy paper confirming that the Senior Managers Regime ("SMR") will extend to capture all Financial Services and Markets Act ("FSMA")-authorised firms in the UK—including interdealer brokers, hedge funds and asset managers—in 2018.

The SMR is intended to encourage individual accountability for decision-making in financial services firms. The first phase of the SMR will affect banks, building societies, credit unions and Prudential Regulation Authority("PRA")-designated investment firms ("banking sector firms"), with the second phase extending the regime to all other FSMA-authorised firms ("other authorised firms").

Although a consultation period will precede formal proposals for applying the SMR to other authorised firms, the policy paper suggests that it will apply in a broadly similar way. This *Commentary* provides an overview of the new regime.

Executive Summary

The changes, which were published in advance in the FCA's CP15/9, will replace the current Approved Persons Regime ("APR") for banking sector firms. Key changes include:

- The SMR will be narrower than the current APR, allowing regulators to focus on authorising and supervising the most senior staff in banking sector firms.
- The list of prescribed responsibilities under the Senior Management Arrangements, Systems and Controls sourcebook ("SYSC") will expand to include financial crime, developing and overseeing remuneration policies, and overall responsibility for compliance with the Client Assets Sourcebook (where relevant).
- Each application for senior manager approval must include a statement of responsibilities ("SoR"); significant changes to any SoR must be notified to the FCA.
- Firms must submit and annually certify a "responsibilities map" illustrating management and governance arrangements.
- The introduction of a Certification Regime will shift the burden of assessing the fitness and propriety of certain staff members onto the relevant firms.

The FCA hopes that these rules will bolster good conduct at all levels, thereby increasing public trust in both the banking system and in the regulatory response to bad behaviour. However, firms will need to act early to prepare for the changes introduced by the new regime.

Individual Accountability

The SMR introduced a “presumption of responsibility” under which the relevant senior manager is guilty of misconduct where an authorised person under his management contravenes a relevant requirement. The Treasury has now acknowledged that reversing the burden of proof is disproportionate, and the measure will be removed.

Nevertheless, senior managers will still face a statutory duty to take reasonable steps to prevent regulatory breaches in their areas of responsibility. The gravity of this responsibility needs to be borne in mind when considering the application of the SMR to staff, as set out below.

To Whom Will the SMR Apply?

Senior Individuals. The SMR will apply to individuals who are subject to regulatory approval and will focus on senior individuals who hold key roles or have overall responsibility for key areas. The onus is on firms to identify the senior individuals who have overall responsibility for the activities of the firm, regardless of their job titles or in which entities they may be based within a group structure.

Non-Executive Directors. Non-executive directors (“NEDs”) in the following positions will be subject to approval and inclusion in the SMR: Chairman, Chair of the Risk Committee, Chair of the Audit Committee, Chair of the Remuneration Committee, Chair of the Nomination Committee, and Senior Independent Director. The FCA has clarified that the SMR will not apply to “standard” NEDs, i.e. those NEDs who do not chair specified subcommittees of the board.

Smaller Firms. The FCA has indicated that the regime is designed to be proportionate, with less complex firms requiring fewer preapproved senior managers. However, there is no indication that de minimis exemptions will be included in the new regime; instead, proportionality is to arise as a by-product of less complex group structures and business activities.

Overseas Firms. The new regime will apply to UK branches of overseas banks and PRA-designated investment firms (“incoming branches”)—the near-final rules are set out in publication CP15/10. The PRA proposes requiring all incoming branches to have at least one individual preapproved as a Head of Overseas Branch. These individuals will typically be performing CEO-type functions.

Alongside this, the FCA proposes to apply a new senior manager function, that of Overseas Branch Senior Manager, to incoming branches. This role captures senior individuals with local responsibility for a business area, activity or management function of the branch who will typically report to the Head of Overseas Branch.

Both the PRA and the FCA acknowledge that it would be unfeasible and disproportionate to apply the list of prescribed responsibilities associated with UK firms to incoming firms. Therefore, both bodies have proposed a customised set of prescribed responsibilities for incoming branches. Neither the PRA nor the FCA intends to bring any NED functions into the scope of the SMR for incoming branches.

The new rules relating to senior management responsibilities for overseas firms will be published at SYSC 4.6 and 4.8.

Certification Regime

The Certification Regime, which will operate in tandem with the SMR, requires banking sector firms to certify the fitness and propriety of staff carrying out functions that could involve a risk of significant harm to the firm or its customers. Examples of such functions include giving investment advice, executing client orders and administering benchmarks. This fundamental shift means that decisions as to who should or should not be an approved person will no longer rest with the FCA (except for senior individuals caught by the SMR), and it will also place new hiring and monitoring responsibilities on banking sector firms.

Wider Scope

It appears from the Treasury’s policy paper that the SMR will apply in a similar manner to other authorised firms: it will replace the APR entirely, and any new senior manager appointments will need to be approved by the regulator.

The Certification Regime will apply to individuals who are not carrying out senior management functions but are still capable of causing “significant harm” to the firm or its customers; this is expected to capture the remaining approved persons within a firm and possibly additional employees who are not currently approved persons. Firms will need to assess the fitness and propriety of such persons during recruitment and certify ongoing fitness and propriety at least annually.

When Will the Rules Come Into Effect?

The new rules come into effect for banking sector firms on 7 March 2016, with new Senior Managers appearing on the FCA register from that date. Individuals currently approved to perform a significant influence function in a relevant firm will be eligible to transition into the new SMR role via a grandfathering notification; the final deadline for firms to submit their grandfathering notifications (including their responsibilities map and SoRs) is 8 February 2016.

For other authorised firms, the Treasury acknowledges the challenge of rolling out the SMR and Certification Regime to 60,000 entities; therefore, the target implementation period for the extended regime is 2018. The consultation period and deadlines have not yet been announced.

Key Points to Consider

The suggestions set out below are more pressing for banking sector firms in the short term, but other authorised firms would do well to start thinking about adjustments early on.

Preparation. It would be prudent for firms to begin identifying the staff roles that will require preapproval under the SMR, and to assess whether any areas of responsibilities require clarification before a SoR can be prepared. In addition, firms should consider whether any changes should be made to hiring and monitoring procedures as part of the Certification Regime, which may include compliance training for affected staff.

Documentation. Firms will need to produce and submit a responsibilities map under the new SYSC 4.5. The map will specify a firm’s management and governance arrangements in a single document, with the Board confirming annually that there are no gaps in the allocation of responsibilities.

Compliance. Firms may also wish to consider amending compliance procedures to ensure that senior managers are taking “reasonable steps” to prevent regulatory breaches in their areas of responsibility. The FCA’s considerations when assessing such steps are set out in the Decision Procedure and Penalties Manual.

Lawyer Contacts

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