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Latham & Watkins Financial Regulatory Practice

18 December 2020 | Number 2840

PRA Publishes Findings on Its Evaluation of the SMCR

The PRA has released a largely positive report, along with nine follow-up actions and recommendations on the SMCR for PRA-regulated firms.

Key Points:

- There is no need for major changes to the SMCR.
- There are some areas of the SMCR that could benefit from amendment and some areas where it is not yet clear whether the SMCR is working as fully intended.
- The report identifies nine follow-up actions and recommendations to refine the way in which the SMCR operates in practice.
- Around 95% of the firms surveyed said that the SMCR was having a positive effect on individual behaviour and that fitness and propriety requirements have supported higher professional standards and personal accountability.

The PRA reviewed the operation of the Senior Managers and Certification Regime (SMCR) against its original objectives and examined whether there have been any unintended consequences. The evaluation covered the period 2019-2020, included evidence from internal and external sources, and examined each component of the SMCR (including across the life cycle of firm and supervisory activity). Whilst the evaluation did not look at FCA solo-regulated firms, the PRA did have discussions with the FCA on some issues and certain of the findings will also be of relevance to FCA solo-regulated firms, given the extension of the SMCR to them from the end of 2019.

Status of the evaluation

Whilst the report is not a formal consultation and does not set out specific proposals for amending the PRA Rulebook or Supervisory Statements, it does include a number of follow-up actions and recommendations.

The PRA welcomes feedback on the issues outlined and the deadline for providing comments is 26 February 2021. Following receipt of the feedback, the PRA will consider if there is a case for proposing changes, which if decided, would follow the usual consultation process. The PRA will also continue to provide firms, individually or at sector level, feedback if it identifies areas in which firms can improve their implementation of the SMCR.

Key findings and themes identified

The PRA's evaluation drew upon internal and external sources, which included:

- A review of regulatory data
- A survey of PRA supervisors
- Structured interviews with practitioners, advisers, and supervisors
- A survey of a sample of 140 PRA-regulated firms and senior individuals
- A review of external publications

Themes

The PRA identified three key "themes" and three follow-up actions and recommendations for each of the themes:

- Holding individuals to account through the SMCR
- Myth busting and clarifying expectations
- Application of the SMCR to different business models

Theme 1 – Holding individuals to account through the SMCR

Background

The need to maintain a credible link between seniority, decision making, and accountability is central to the SMCR. Firms and supervisors can use a variety of tools in order to achieve this, including: clarity in allocation of responsibilities; clarity as to the criteria for fulfilling those responsibilities; accountability of decision makers for their actions; and the creation of incentives (through variable remuneration for example) that give accountability traction.

The PRA's view is that the SMCR principally acts as a supervisory tool, which is supported by the fact that in an internal survey in 2019, 70% of supervisors found that the SMCR had helped them to hold individuals to account, as demonstrated by the fact that the PRA currently has 16 enforcement investigations into individuals open, with one additional matter pending before the Upper Tribunal. However, the PRA notes that the SMCR was not designed simply as a tool for regulators, but to also help firms strengthen their internal processes.

Findings

From a survey of banks and insurers, 94% of senior managers and 96% of firms reported that the SMCR had brought about positive and meaningful changes to behavior in industry. Those respondents that did not attribute improved behaviours to the SMCR stated that they had already placed considerable emphasis on individual accountability and therefore the additive effect of the new requirements was immaterial. Whilst the majority of respondents considered that the SMCR captured the appropriate individuals at senior manager level, this dropped to 89% in relation to the certification regime, with 10% of survey respondents suggesting that the certification regime captured too many individuals.

There was a very positive response from firms relating to the integration of the SMCR into their business as usual practices, in ways that went beyond simple regulatory compliance, with 97% of firms reporting that this was the case. Some firms even provided examples of how the implementation of the SMCR prompted improvements in internal processes, such as better handover arrangements between senior staff, improved clarity of board responsibilities, and improved training.

The PRA has interpreted the results of the survey using a degree of caution, but nevertheless acknowledges that the positive feedback suggests that the SMCR is viewed by a large group of practitioners as offering a sound framework for enhancing governance. This is also supported by the results of the Banking Standards Board (BSB) annual survey. In the survey, the positive response to a specific statement relating to senior leaders taking responsibility — especially if things go wrong — had increased from 58% in 2016 to 66% in 2019. However, this in effect means that some 34% still do not agree with the statement, which in one view is surprising and somewhat disappointing given the underlining purpose of the SMCR.

Some firms reported challenges in using regulatory references, including a reluctance to hire individuals who had an adverse comment on their reference and a corresponding sensitivity on the part of employees to such comments. The evaluation also identified that conduct notifications are only being used to a limited extent. It was also unclear from the PRA's evaluation whether the SMCR has resulted in larger or more frequent adjustments to individuals remuneration, but the PRA observed that whilst the SMCR and remuneration requirements are separately dealt with in PRA policy documents, there is a case for making the link between the two approaches to individual accountability clearer.

Key follow-up actions and recommendations

The PRA will:

- Examine the scope for clarifying expectations related to misconduct reporting in notifications and regulatory references and engage with industry so that regulatory references are used in an appropriate manner
- Seek feedback on the benefits of further articulating the link between the SMCR and remuneration adjustments, potentially pronouncing the position more clearly in policy documents
- Underline the responsibility of those holding Prescribed Responsibilities for the SMR and the Certification Regime to embed these

Theme 2 – Myth busting and clarifying expectations

Background

Pre-SMCR implementation, there was a concern that the unintended consequence of the regime would be the impeding of diversity. Specifically, there was concern that the SMCR would reduce the attractiveness of senior roles in the regulated sector to external candidates, and a potential risk that firms might be tempted to put forward candidates with similar characteristics to past candidates to facilitate regulatory approvals.

Findings

The evaluation identified that some misconceptions remain within the SMCR and that it would be helpful to clarify the PRA's expectations in a few areas in order to support consistent implementation and to avoid unintended consequences. The areas identified were diversity, collective accountability, and interim appointments.

Prior to the SMCR, there was some concern that:

i. Firms might find it increasingly challenging to find people to undertake senior roles given the new responsibilities entailed.

ii. Greater emphasis on senior management accountability might discourage some candidates from outside the UK-regulated financial services sector from applying for a senior manager role, with implications for the skills and diversity of firms' senior management.

In relation to point (i), most firms report that the SMCR has not hindered them from recruiting the appropriate individuals, and on point (ii), the evaluation found no evidence to support or reject this concern due to the lack of quantitative data available.

The responsibilities under the SMCR of senior managers are designed to be additional and complementary to those statutory and fiduciary duties of directors under UK company law and relevant corporate governance codes. The survey found that respondents found the SMR to complement board responsibility, although a few respondents noted there was some tension.

The PRA received feedback from firms during the evaluation that there could be greater clarity in terms of the application of the 12-week rule. The PRA (and FCA) are consulting in CP20/23 on clarifying their expectations for temporary and long term absences, with responses on this particular point due by 4 February 2021. CP20/23 acknowledges that the current rules and guidance are not sufficiently clear on whether individuals can retain regulatory approval during long term leave or the notifications that are required. This point has generated a lot of questions and the industry is likely to welcome guidance and clarity in this area.

Key follow-up actions and recommendations

The PRA suggested a number of recommendations, including:

- Reaffirming its appetite for diverse skills and experience among senior management (through policy, expectations, and/or communication) and examining options for improving data collection and analysis of diversity amongst the senior management population
- Seeking further views on whether board responsibilities and individual accountability are mutually reinforcing
- Consulting on clarifying regulatory expectations in cases where senior managers takes temporary leave for longer than 12 weeks

Theme 3 – Application of the SMCR to different business models

Background

The SMCR covers all PRA-regulated firms (banks and insurers, international and domestic institutions of differing size and foreign branches operating in the UK, mutual and non-mutual sectors) and therefore it needs to be sufficiently adaptable so that it can be used and implemented across different firms and business models.

Findings

The majority of firms that were surveyed felt that the SMCR was sufficiently adaptable and a majority of firms reported that the SMCR was proportionate. However, PRA Category 3 and 4 firms disagreed on the proportionality point.

As a result of the evaluation, some areas were identified where it would be timely to obtain further views from stakeholders on the flexible application of the regime, and on the need for additional guidance. The report also identified that greater use of time-limited and conditional SMF approvals would give additional flexibility to the regime and that it would be helpful for the PRA to provide detail on a specific section of its website those senior management expectations that are created in respect of new and evolving risks (i.e. COVID-19, benchmark transition, climate change).

Key follow-up actions and recommendations

The PRA will seek further views on a number of points:

- Why the use of the SMF6 (Head of Key Business Area) is used less at insurers than at banks
- The way in which the designation of certain individuals as Key Function holders works alongside the SMCR
- Whether there is a case for further guidance in allocating Prescribed Responsibilities
- If there is an option for smaller firms to submit SMCR documentation less frequently

The PRA will also explore and consider:

- Options for making time-limited and conditional approvals more readily used in the appointment of senior managers
- Creating an inventory (contained on the Bank of England website) of guidance and expectations of senior manager responsibilities for new and emerging risks and for supervisors to work within the existing set of senior manager policy expectations where possible.

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