

The (Potentially) Long Arm of the SMCR

Firms will need to consider whether any individuals in group entities require approval as Senior Managers.

Introduction

Much has already been written on the proposed extension of the Senior Managers & Certification Regime (SMCR) — with a recent flurry of activity following publication of the FCA’s long-awaited Consultation Paper 17/25 (the CP) (see Latham’s earlier [Client Alert](#), which provides a high-level summary of the proposals).

This *Client Alert* addresses certain specific issues raised in relation to the potentially wide reach of the regime (including extraterritorial impact) — a potential area of concern for non-UK headquartered groups containing one or more UK-regulated entities. A basic knowledge of the SMCR framework is presumed.

As with any regulatory consultation paper, the CP’s proposals are subject to change. This *Client Alert* proceeds on the assumption that the relevant provisions of the CP will remain in substantively similar form.

Contextual backdrop

There are a number of ways in which individuals who are not, at first glance, obviously within the ambit of the SMCR may nevertheless be brought within scope — and thereby required to gain approval as a Senior Manager.

Group-wide reach

As a fundamental premise of the SMCR, an individual who exerts significant influence on the management or conduct of one or more aspects of a UK-regulated firm’s affairs, or on its governing body, *may* be required to be approved as a Senior Manager of the firm and to thereby become subject to the FCA’s regulatory oversight.¹ In practice, this would either be as a Group Entity Senior Manager (SMF7) (in the case of Enhanced firms) or as an “extended” Executive Director (SMF3) or “extended” Partner (SMF 27) (in the case of Core firms).

“Arrangement”?

An initial “gateway” consideration is whether the firm has an “arrangement permitting the performance of these roles by the person concerned”. An “arrangement” does not need to be a written contract and can arise by conduct, custom, and practice. Where there is no “arrangement”, there will be no need for the individual to be approved as a Senior Manager. Ultimately this will be a question of fact, and many firms may well be reluctant to rely solely upon this particular ground as a reason for concluding that an individual does not need to be approved — especially given the breadth of the FCA’s interpretation of “arrangement”.

Group Entity Senior Manager (SMF7)

SMF7 (Group Entity Senior Manager) is designed to draw into scope employees or officers of other group (often parent) entities — **wherever located** — who exercise significant influence on the management or conduct of the affairs of the UK-regulated entity. An individual will not need to become an SMF7 unless (s)he is performing a function that requires him/her to: (i) be responsible for managing one or more aspects of the firm’s affairs, so far as relating to the carrying on of a regulated activity by the firm; and (ii) where those aspects involve, or might involve, a risk of serious consequences for the firm, or for business or other interests in the UK.

The question of whether or not an individual is caught will be a case-by-case, fact-specific determination. However, the FCA has provided some useful guidance on the considerations firms should take into account.

When considering the potential applicability of SMF7, it should be noted that:

- Individuals in the management of a group in which a firm is a subsidiary do not automatically fall within SMF7, even though their job may relate to the firm.
- The FCA does not expect to approve individuals to perform SMF7 for every firm that belongs to a group, merely because the firm is part of a group.
- The FCA would not consider it to be unusual for there to be no one performing SMF7 for a firm that is a subsidiary in a group.
- The parent of a subsidiary firm cannot itself perform the SMF7 function.
- A shareholder in the parent will also not perform SMF7 unless the shareholder is also a director, officer, or employee of the parent and is exerting significant influence over the firm through that role.

The factors to be taken into account in assessing whether someone performs the SMF7 function include (our emphasis):

- The organisational structures of the group and firm
- The split of key responsibilities between group and firm boards and senior management
- Whether Senior Managers in the firm have an **appropriate level of authority** within the group to ensure that the firm complies with the requirements of the regulatory system

The CP offers some potentially helpful further guidance. An individual based elsewhere in a group whose responsibilities in relation to the subsidiary in the group (the UK-regulated firm) are limited to developing the group's overall strategy is unlikely to be performing SMF7. Rather, SMF7 is more likely to apply to individuals who are directly responsible for implementing the group's strategy in the firm. Therefore, if an individual based elsewhere in the group: (a) is directly responsible for taking decisions about how the firm should conduct its regulated activities; and (b) has not delegated this responsibility to an SMF holder based in the firm, (s)he likely will require approval to become an SMF7.

The CP goes on to clarify that *"if, however, the firm's governing body has **sufficient discretion** in how it applies and responds to proposals coming from group committees or individuals based in parent entities, approval [for SMF7] would generally not be required. In this case, the individual will be carrying on a group-level function rather than performing a function on behalf of the firm"* (our emphasis).

Therefore, where a firm has in place the requisite Senior Managers based in the firm, and those Senior Managers are effective and have sufficient control over the firm, the FCA would not ordinarily expect the firm to have any SMF7s.

Clearly, a key consideration when assessing the need to designate someone as an SMF7 is the degree of control, discretion, and general autonomy enjoyed by the board / governing body of the firm. Where such genuine independence can be readily demonstrated — most obviously, through board minutes and papers, as well as reporting lines — there ought to be a strong argument that no SMF7 appointments are necessary.

In this regard, it is also worth noting that under the Companies Act, company directors are (amongst other responsibilities) duty bound to act with independent judgment. It would appear to follow that, if the directors are discharging this duty properly, then SMF7 should not — in theory, at least — be an issue.

Practical framework

A firm facing an SMF7 predicament might usefully work through the flow chart on the following page.

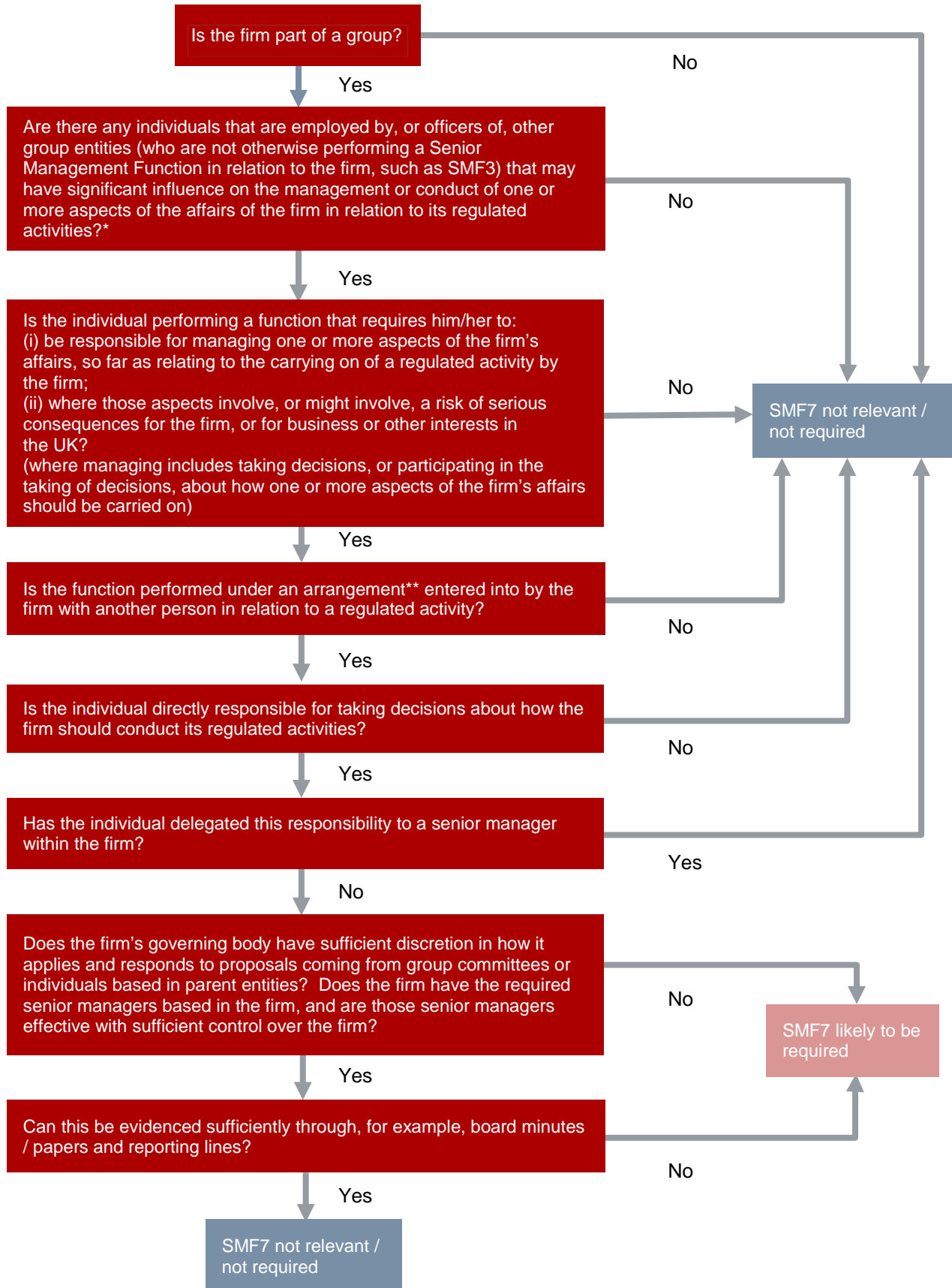
Extended Executive Director (SMF3) or Extended Partner (SMF27)

For Core firms, individuals situated elsewhere in the group (and wherever located) could require designation as an SMF3 (executive director) or SMF27 (partner) — on either (or both) of the following bases:

- They occupy the position of a director/partner (by whatever name called).
- They are a person in accordance with whose directions or instructions the directors/partners [of the UK-regulated firm] are accustomed to act.

The flowchart can similarly be used to assist Core firms with these determinations.

Application of SMF 7 (UK Enhanced firms only)



***Factors to take into account:**

- The organisational structures of the group and the firm
- The split of key responsibilities between the group and firm boards and senior management
- Whether senior managers based in the firm have an appropriate level of authority within the group to ensure that the firm complies with the requirements of the regulatory system.

****What is an “arrangement”?**

- Can be any kind of arrangement for the performance of a Senior Management Function
- Includes the appointment of a person to an office, a person becoming a partner, or a person's employment (whether under a contract of service or otherwise)
- An arrangement need not be a written contract but could arise by conduct, custom, and practice

Conclusion

As highlighted, a number of conditions must be satisfied before concluding that an individual based elsewhere in the group requires approval as a Senior Manager under the SMCR.

Where it has been determined that one or more of these pre-conditions has not been met, it would be prudent for firms to document the basis upon which such a conclusion was reached, bearing in mind that the FCA may seek to scrutinise firms' approaches to applying the SMCR once firms start transitioning to the new regime. It will also be important to ensure that any reliance upon the autonomy/independence of the firm's governing body and/or its local Senior Managers is readily demonstrable. In this way, firms should be well-placed to respond to any potential questions or challenge from the FCA.

It is by no means a foregone conclusion that, for example, a non-UK headquartered group with a UK-regulated subsidiary must have one or more SMF7s or “extended” directors/partners (as the case may be). In our experience, it can pay to undertake a methodical assessment by reference to the above framework.

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Endnotes

- ¹ Incidentally, this is not a new concept *per se*. The existing approved persons regime encompasses 'extended' directors (CF1s) and 'extended' non-executive directors (CF2s) — being those individuals within a parent or holding company whose decisions or actions are regularly taken into account by the governing body of the UK-regulated firm.