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Client Alert

Financial Regulatory News Flash

Latham & Watkins Financial Regulatory Practice | 27 July 2017 | Number 2186

FCA Publishes Long-Awaited Consultation Papers on the Extension of the SMCR

The FCA will take a proportionate approach, reflecting the diversity of firms within the proposed regime's remit.

On 26 July 2017, the FCA published its long-awaited Consultation Papers on the extension of the Senior Managers and Certification Regime (SMCR) to all authorised firms. The "main" paper ("Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA Firms" — Consultation Paper 17/25 (the Paper)) does not cover the FCA's proposals for insurers, which are covered separately in Consultation Paper 17/26. The FCA states that the operational aspects of the new regime (including how firms will transition to the new regime, and the template for Statements of Responsibilities and the process for submitting them) will be consulted on separately in a third technical consultation paper.

As stated by the FCA, the Paper affects "almost every firm that offers financial services and is regulated by the FCA", including those that are already covered by the SMCR as the FCA proposes "a few" additional changes which will also affect them. Whilst the FCA's desire is for consistency across the market, as promised, the FCA is intending to take a proportionate approach to the extension given that the expanded regime will capture all firms from large insurers down to small intermediaries. For example, the requirement for Prescribed Responsibilities will not apply to some firms (sole traders, EEA branches, firms with limited permissions) but more responsibilities will apply to bigger firms. Further, the FCA will define Senior Management Functions depending on the type of firm involved.

The consultation is open until 3 November 2017, but the FCA has not given any further indication of timing for implementation (other than a vague statement that the FCA will publish final rules "next year").

Background

The SMCR has applied to banks and the largest investment firms since 7 March 2016, but even before the main SMCR came into effect, the government had stated its intention to extend the regime to all firms authorised under the Financial Services and Markets Act 2000 from 2018. The government passed legislation in early 2016 to enable the extension of the regime, with the relevant provisions to be "switched on" by HM Treasury at the appropriate time.

However, while firms have known that the extension was on the way, they have had little information about the content of the extended SMCR (the legislation says very little, as most of the detail will be set out in the regulators' rules and guidance). Save for the regulators indicating that the extended SMCR would contain the same basic elements as the regime for banks, but that it would be fashioned so as to reflect the different risks, impact, and complexity of firms within its remit, there has not been much information on the detail so far. More recently, the FCA has hinted further, including mention of a potential special prescribed responsibility for fund managers in the FCA's findings from its asset management market study, and the application of the regime to benchmark administrators in the FCA's consultation on UK implementation of the EU Benchmarks Regulation.

Key Elements

Like the regime for banks, the proposed extended SMCR will feature three distinct elements (what the FCA refers to as a "core regime", which will apply to, and set baseline requirements for, every FCA solo-regulated firm (except Limited Scope Firms)):

- **Senior Managers Regime:** a regime for the most senior individuals within the firm, requiring those individuals to obtain prior regulatory approval. Firms must allocate responsibilities to senior managers and document them in statements of responsibilities and management responsibilities maps. Senior managers are subject to a "duty of responsibility", potentially making it easier for a regulator to find them guilty of misconduct if something goes wrong on their watch. In this Paper, the FCA proposes a set of "core" Senior Management Functions (SMFs) that apply to all firms (unless a specific exception applies) and almost all of these functions are currently controlled functions under the Approved Persons Regime (APER). On the basis of proportionality, however, the FCA will approve only the Chair, not all Non-Executive Directors (NEDs), meaning some NEDs currently approved under APER will not need to be approved by the FCA under the SMCR. Extra SMFs will apply to "enhanced firms", and Limited Scope Firms will only need to apply some of the SMFs. Much of the content of the relevant Chapter (Chapter 4) is otherwise familiar: the requirement for Statements of Responsibilities, the Duty of Responsibility (where the burden of proof remains with the FCA), and the possibility of holding more than one SMF. In respect of Partnerships (as is currently the case under APER), all partners in a firm will be Senior Managers.

- **Certification Regime:** a regime capturing the residual population of individuals who are currently approved persons but who are not senior managers under the new regime. This regime only applies to employees, not Non-Executive Directors (NEDs). The regulator does not approve individuals covered by this regime r; the responsibility lies with the firm to assess their fitness and propriety both before they commence their role and on at least an annual basis thereafter. The firm must issue a certificate to that employee (satisfying certain conditions) that confirms their fitness and propriety (see "Fit and Proper Requirements" set out below). The firm must also decide whether to withdraw certification if the individual's fitness and propriety ever becomes uncertain. The FCA in this Paper sets out its proposed Certification Functions (which will only apply where the firm has people in the relevant roles — where the firm has no such roles, the Certification Regime will not apply) and asks firms to suggest any additional ones that should be included. Further, the FCA asks firms to consider whether individuals holding Certification Functions should be made public (*i.e.*, the individuals and their functions disclosed on the FCA register).

- **Conduct Rules:** new conduct rules that apply directly on an almost firmwide basis (excluding only "ancillary staff" such as cleaners and caterers), allowing the regulators to take disciplinary action against a greater range of individuals when there has been a breach by the firm. The rules are split into two "tiers"; a set of "core" conduct rules for most staff, plus some additional rules that apply only to senior managers. The conduct rules also bring various obligations for firms, including requirements to make staff aware of the rules, train staff appropriately, and report disciplinary action taken by the firm against individuals for breach of the rules to the regulator. The Conduct Rules will apply to a firm's regulated and unregulated financial services activities, including any related ancillary activities.

The new regime will then impose extra requirements (for example, handover procedures), in addition to the core regime, on only the largest and most complex firms ("enhanced firms") consisting of less than 1% of FCA solo-regulated firms. Chapter 8 of the FCA's Paper covers these additional requirements.

Key Features of the Extended Regime and Points of Contrast

Additional key features of the Paper are set out below:

- **Prescribed Responsibilities:** the FCA proposes six extra responsibilities that must be given to Senior Managers, and an additional responsibility for authorised fund managers; firms will need to consider carefully who receives these extra responsibilities. Where a firm is a Limited Scope Firm, the Prescribed Responsibilities will not apply. Where a firm only has one Senior Manager then the firm must prescribe all of the Prescribed Responsibilities to this person. For Enhanced Firms, in addition to the seven responsibilities mentioned, an additional seven will apply.

- **New Prescribed Responsibility for Conduct Rules:** all firms (including banking firms currently caught by SMCR) will be required to allocate a Senior Manager to ensure that the firm trains staff on the Conduct Rules and complies with the FCA notification requirements. These notification requirements require firms to notify the FCA of disciplinary action which is taken as a result of a breach of the Conduct Rules (within seven business days in respect of individuals who are Senior Managers).

- **Fit and Proper Requirements** — the FCA proposes:

  - Applying the requirement to ensure that anyone performing a Senior Management Function or Certification Function is fit and proper to perform their role to Non-Executive Directors who are not senior managers.
  - Extending the application of FIT (in the FCA Handbook) to Senior Managers and certified staff in solo-regulated firms.
  - Requiring firms to collect new evidence when assessing candidates for Senior Management roles, Certification Functions, or Non-Executive Directorships (even if the relevant NED is not a Senior Manager). Under the new regime, firms will need to conduct criminal record checks on each Senior Manager (as part of their application for approval) and NEDs who are not Senior Managers where a fitness requirement already applies to them. Further, firms will need to comply with the requirements relating to "regulatory references".

- **CASS functions:** the FCA acknowledges that the CASS Oversight Function is often operationally focused, so the same individual responsible for CASS compliance under the CASS Prescribed Responsibility (who would be a Senior Manager) may not also carry out this CASS Oversight Function. Accordingly, the FCA allows for some flexibility here and proposes that where this is the case, the person with the CASS Oversight Function will fall under the Certification Regime and will therefore not require FCA approval.

- **"12 week rule":** the FCA proposes amendments to the "12 week rule" (which states that firms can allow an individual to cover for an Approved Person / Senior Manager without being approved where the appointment is for less than 12 weeks and the absence is unforeseen or temporary). The FCA will extend the amendment to cover responsibilities under the "Overall Responsibility" requirement, not just the Senior Management Functions.

Timing

The original SMCR is notorious for undergoing numerous FCA tweaks both before and after it came into effect, so firms affected by the extension will no doubt be hoping for a smoother path to implementation.

How Should Firms Approach Implementation?

Although there is plenty of reading for the time being, firms should also ensure that they read the feedback provided by the FCA in September 2016 on how the banks had handled implementation. Many of the issues raised by the FCA are not specific to the regime for banks, and should help firms avoid common pitfalls when implementing the regime. Further, firms should read Chapter 3 of the new FCA Paper ("Guide to the regime") and Chapter 11 ("Reader's Guide to the Instrument", *i.e.*, the new rules) to assist them both with their reading of the new rules and their initial assessments, including scoping. In terms of Handbook changes, the FCA is not proposing to delete the material currently in SYSC 4.5-4.9, but will "renumber and re-order it quite substantially". Therefore, even firms already subject to the SMCR should review the changes to the rules carefully.

Another important point to remember is that the SMCR has cropped up in numerous speeches about culture and conduct over the past few years. A tick-box approach to implementation will not satisfy the regulators — they expect firms to embrace wholeheartedly the underlying principles of the regime and use the principles as a driver for cultural change. Even in smaller firms where any cultural issues may be less prolific, the regulators will expect a thoughtful and conscientious approach.

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