SM&CR

FCA proposes extension to all firms

The FCA has published a consultation paper (CP17/25) on extending the Senior Managers and Certification Regime (SM&CR) to almost all financial services firms. The SM&CR currently only applies to banks, building societies, credit unions and PRA-designated investment firms (the FCA defines these as "banking firms"). However, in May 2016, Parliament made legislative changes requiring the FCA to apply the SM&CR more widely.

The FCA and PRA have also published separate consultation papers (CP17/26 and CP14/17 respectively) on how they propose to extend the SM&CR to insurers. These papers are not considered in this bulletin.

General approach

The regulators introduced the SM&CR in March 2016 to increase individual accountability in banking firms. The SM&CR replaced the Approved Persons Regime for these firms, under which the FCA regulates individuals working in financial services. In CP17/25, the FCA proposes to replace the Approved Persons Regime with the SM&CR for all other financial services firms, of which it estimates there are approximately 47,000 in the industry.

The FCA states that the aim of the new SM&CR is to strengthen market integrity and reduce harm to consumers by creating a system that drives individual accountability in firms. The FCA emphasises that it wants "all firms to develop a 'culture of accountability' at all levels and for senior individuals to be fully accountable for defined business activities and material risks".

Helpfully, the FCA recognises that it is not appropriate for it to use the same approach in applying the new SM&CR to the wider financial services industry as it did when applying the SM&CR to banking firms. Instead, the FCA has adapted the tools and principles from the banking SM&CR to be more in line with the different risks, impact and complexity of firms in scope of the extended regime. CP17/25 also highlights the FCA's focus on developing a flexible and proportionate SM&CR, to account for the different governance structures and business models of firms.

Key proposals

The FCA proposes the following three-tier model for the new SM&CR:

- **Core Regime**: the FCA proposes to apply a standard set of requirements to all firms that it regulates, which are not currently subject to the SM&CR (solo-regulated firms) and which do not fall into either the "Enhanced Regime" or the "Limited Scope Regime" described below. It refers to firms in this regime as "Core Firms". These requirements are further divided into the same three elements as the current SM&CR: (1) the Senior Managers Regime; (2) the Certification Regime; and (3) Conduct Rules.
- **Enhanced Regime**: for a small number of solo-regulated firms whose size, complexity and potential impact on consumers justify further attention (Enhanced Firms), the FCA plans to impose additional requirements. Such firms include those with assets under management of £50 billion or more (at any time over the past three years) and investment firms categorised as "significant IFPRU investment firms" for prudential purposes.
- **Limited Scope Regime**: firms subject to a limited application of the current Approved Persons Regime will only have to comply with a reduced set of requirements (Limited Scope Firms). This includes internally managed AIFs, limited permission consumer credit firms and sole traders.

A summary of the main features of each regime is set out below. In addition, the FCA proposes some changes to how the current SM&CR applies to banking firms, including applying the new "Partner Senior Management Function" and the introduction of a new "Prescribed Responsibility" for Conduct Rules, to ensure firms train their staff in the Conduct Rules and comply with the associated notification requirements.

Core Regime

Under the Senior Managers Regime element, individuals performing FCA-defined "Senior Management Functions" will need FCA approval before starting their role. These individuals will be "Senior Managers", who must also have a "Statement of Responsibilities" setting out clearly what they are accountable and responsible for. Core Firms must allocate Prescribed Responsibilities to the appropriate Senior Manager. In addition, each Senior Manager will be under a "Duty of Responsibility", meaning they could be held accountable for a regulatory breach within their area of responsibility if they did not take reasonable steps to prevent that breach.

The Certification Regime applies to individuals who are not Senior Managers but who may cause significant harm to the firm or to customers due to the nature of their role. Such individuals do not need prior FCA approval but firms must certify that they are fit and proper to perform their role at least once a year. The Conduct Rules set high-level standards of behaviour and apply to all employees in a financial services firm, with certain rules only applying to Senior Managers.

Enhanced Regime

Additional Senior Management Functions will apply to an Enhanced Firm's business, and such firms will have to allocate more Prescribed Responsibilities compared to Core Firms. The FCA also proposes that Enhanced Firms comply with the requirement to have adequate handover procedures, where a person taking over a new role as a Senior Manager must have all the information and material that they could reasonably expect to perform their role.

In addition, the requirement to have a single document setting out management and governance arrangements (a Responsibility Map) will apply to Enhanced Firms. Such firms must also ensure that there is a Senior Manager with overall responsibility for each area of the firm.

Limited Scope Regime

Apart from the obligation to allocate Prescribed Responsibilities, Limited Scope Firms will have to comply with the same requirements as Core Firms (as summarised above). Fewer Senior Management functions will also apply to Limited Scope Firms.

Particular issues for LLPs

Firms within the Core or Enhanced regimes which are structured as a limited liability partnership (an LLP) or a standard partnership will be subject to SMF27 - the Partner Senior Management Function. This Senior Management Function captures "A partner in a firm, other than a limited partner in a partnership registered under the Limited Partnership Act 1907." For many asset managers (including a number of private equity firms), the breadth of this function may well raise questions as to the scope of the Senior Management Functions to their business, particularly where a large number of team members below the most senior tier of management have been admitted as partners in their regulated LLP or where an LLP has passive investor members. It is hoped that only those actually performing a senior management role will be caught by this function, although it is possible that some firms may seek greater clarity on this point during the consultation process.

Next steps

CP17/25 closes for response on 3 November 2017. After considering the feedback it receives, the FCA aims to publish its final rules in a policy statement next year and HM Treasury will specify when the new regime comes into force. It is unclear when this may be, although an FCA webpage states that it "expects the regime will commence from 2018" and the FCA has informally hinted to industry representatives that this is likely to be closer to the end of 2018 rather than the beginning. This may mean a short implementation timeframe for firms, but the position will be hopefully clearer in due course.

The FCA intends to publish an additional consultation paper on how the new SM&CR will apply to firms that are appointed representatives, as well as a consultation paper on the operational aspects of the new regime. The FCA states that the latter will include transitional arrangements, which may compensate for a potentially short implementation period. It is expected that the phased implementation will mirror that of the SM&CR for banking firms.

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