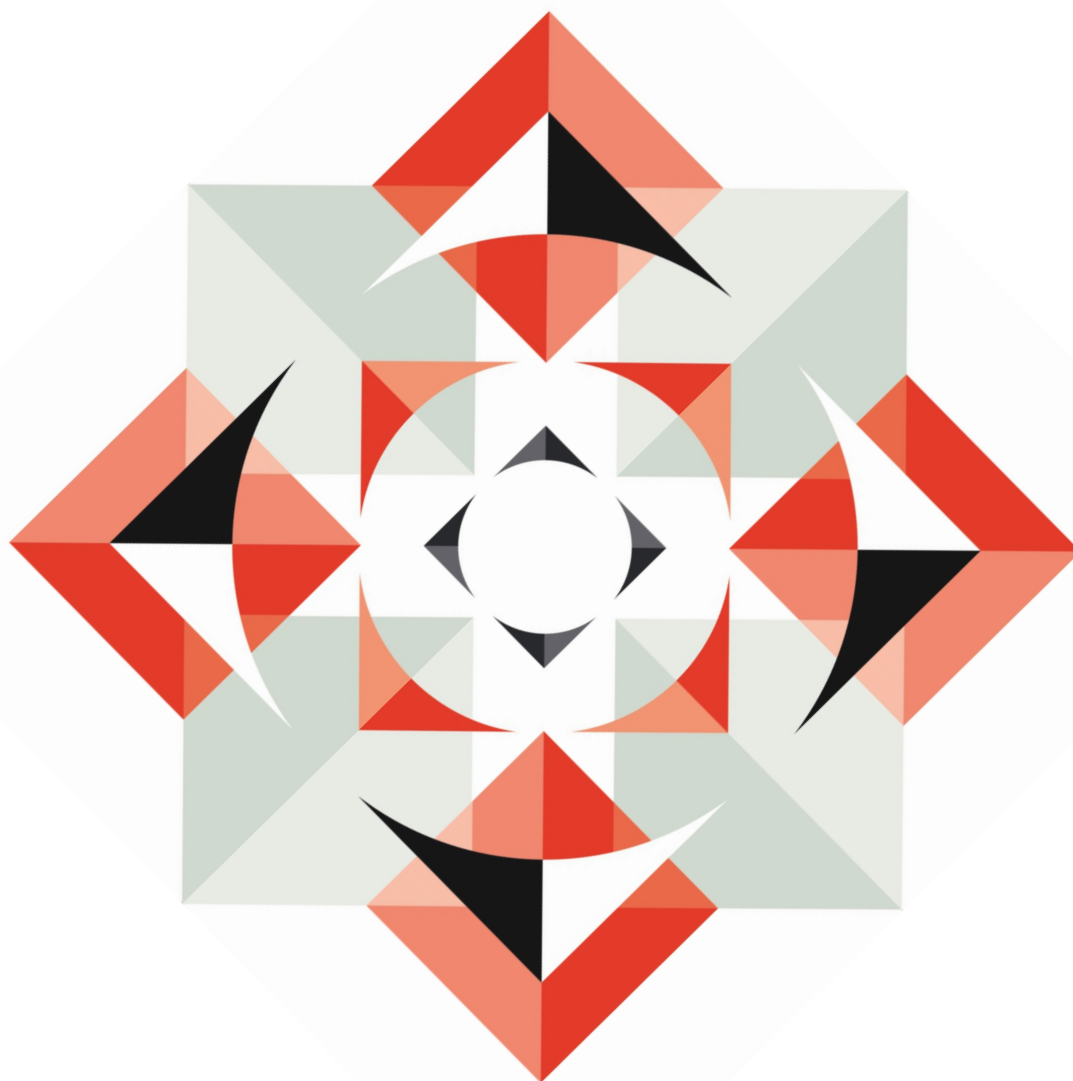


Senior Managers Regime, Certification Regime and Conduct Rules



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Introduction

Banks and other financial institutions are seeing some of the most significant regulatory changes affecting staff in many years.

On 7 March 2016, the Senior Managers Regime, Certification Regime and Conduct Rules came into force. These reforms are intended to strengthen accountability and encourage good governance. The new regime requires clear delegation of responsibilities to senior managers and, crucially, makes it much easier for them to be held personally liable for governance failures.

Background

The Senior Managers Regime, Certification Regime and Conduct Rules are a response to the role felt to have been played by inadequate oversight and accountability in causing the global economic crisis.

In July 2013, the Parliamentary Commission on Banking Standards published a report entitled "Changing Banking for Good". Key proposals from that report were legislated in the Financial Services (Banking Reform) Act 2013 (the Banking Reform Act), which amended the Financial Services and Markets Act 2000.

Which organisations are covered by the New Regime?

The new regime applies to:

- > "Deposit-takers" – i.e. banks, building societies and credit unions
- > Investment banks regulated by the Prudential Regulation Authority
- > Branches of non-EEA banks which operate in the UK, provided that the branch is not merely accepting deposits but is also carrying out other regulated activities
- > A more limited regime applies to branches of EEA banks operating in the UK

The Senior Managers Regime

The Senior Managers Regime (SMR) is the lynchpin of the government's plan to increase individual accountability in the financial sector. It:

- > introduced new requirements for banks to allocate prescribed responsibilities to specific individuals. These proposals will need to be pre-approved by the relevant regulator; and
- > significantly, allows regulators to find individual senior managers culpable for governance failures unless the senior manager can show they took reasonable steps to avoid them.

Who falls within the SMR?

Anyone carrying out one of 22 "senior manager functions" is a "Senior Manager" for the purposes of the SMR. This will include:

- > All executive directors
- > Non-executive directors with specific responsibilities, such as the Chairman, and the Chairs of the Risk, Audit, Remuneration and Nomination Committees, and
- > All individuals below Board level who have overall responsibility for a key business area or key function and report to the Board on it

How is responsibility allocated?

Responsibilities can be allocated to Senior Managers in one of two ways.

> **Role-dependent allocation**

Certain roles (for example, the CEO, CFO and Chief Risk Officer) are considered to have certain inherent responsibilities that must formally be allocated to the individual carrying out the role.

> **Others**

In total there are around 30 prescribed responsibilities that firms must allocate to an appropriate senior manager. Some of these are quite vague – for example, being responsible for overseeing the adoption of the firm's culture in day to day management.

Presumption of responsibility

Previously, it has been for the regulator to show that an approved individual was personally responsible for or knowingly concerned in a breach of a regulatory requirement.

Under the SMR, this changed. Senior Managers will be held liable for any contravention of a regulatory requirement in an area for which they have responsibility – even if they personally had nothing to do with the breach – unless they can prove that they took such steps as a person in their position could reasonably be expected to take to avoid the breach.

The steps needed will vary from case to case, but guidance issued so far suggests the regulator will look at factors such as the size, nature and complexity of the firm, the Senior Manager's due diligence on taking up the role, the resourcing of specific business areas, the Senior Manager's delegation to subordinates,



and whether the Senior Manager appropriately sought expert advice at any time.

New criminal offence

The Banking Reform Act creates a new criminal offence where a Senior Manager assents to a decision that causes a bank to become insolvent while being aware that the decision might cause the bank to fail and their

conduct falls *"far below what could reasonably be expected of a person"* in that position.

Sanctions include unlimited fines and imprisonment of up to seven years.

This is expected to have limited impact: the failure of financial institutions is rare, and will seldom be demonstrably "caused" by a single decision.

The Certification Regime

The Certification Regime replaced the previous FCA "approved persons" regime for affected institutions in March 2016.

Under the previous regime, the FCA was responsible for pre-approving staff who undertake "controlled functions" (senior decision-makers and staff who liaise directly with clients and customers). The Certification Regime introduced two key changes:

- > It scrapped the concept of "controlled functions". Instead, all staff who are not senior managers under the SMR, but who occupy "significant harm functions", meaning they pose a risk of significant harm to the firm or any of its customers, must be certified.
- > It shifted the burden of certification on to firms themselves. The FCA will not approve staff carrying out "significant harm functions". Instead, firms must perform their own internal vetting to certify relevant staff as fit and proper.

This includes:

- > Conducting criminal record checks
- > Seeking regulatory references for the previous five years of a candidate's employment history
- > Considering a candidate's relevant performance.

The Conduct Rules

New Conduct Rules replaced and extended the application of the Statements of Principle for Approved Persons (known as APER) for affected institutions. Individuals covered by the Certification Regime or the SMR became subject to the Conduct Rules on 7 March 2016. Other staff became subject on 7 March 2017.

The new regime greatly extended the application of the Conduct Rules. These apply much more widely than APER and set out a basic standard for behaviour for everyone in financial institutions (with the exception of those performing ancillary administrative functions, such as switchboard operators, security guards and cleaners). They apply to both regulated and unregulated activities.

There are two tiers of Conduct Rules – those applicable to everyone, and those applicable solely to Senior Managers. The Rules impose greater responsibility on both individuals and firms:

- > All staff are subject to a new (FCA-only) duty to *"pay due regard to the interests of customers and treat them fairly"*. Up Previously, this obligation had applied only to firms as a whole. For the first time, the Conduct Rules confer individual responsibility for customer management (including product selling and wealth management).
- > Senior Managers are subject to new requirements to:
 - > *"disclose appropriately any information of which the FCA or the PRA would reasonably expect notice"*, which some have described as a duty to blow the whistle; and
 - > delegate only to *"appropriate persons"* and to *"effectively oversee"* the discharge of the delegated responsibility. This prevents Senior Managers from escaping personal liability by delegating to others.
- > Firms are subject to a new responsibility to report to the FCA or PRA where they *"know or suspect"* that a breach of a Conduct Rule has taken place. Previously, firms were only

required to report serious breaches or where an approved person is dismissed or suspended.

- > Firms are also required to train all staff on the application of the Conduct Rules, with certain staff required to undertake further training in specialist areas.

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