

# An Introduction to the Senior Managers and Certification Regime

## Introduction

The Senior Managers and Certification Regime (the “**SM&CR**”) is a new regulatory framework to improve banking culture and increase individual accountability within the financial services industry.

The SM&CR was implemented following the Parliamentary Commission on Banking Standards (PCBS) June 2013 report “Changing Banking for Good” in which it was reported “a lack of personal responsibility has been common place throughout the industry.” In summary, the PCBS report concluded that individuals working in banking were not willing to take responsibility for decisions and encountered little realistic prospect of financial penalties or more serious ramifications proportionate with the severity of the failures with which they were associated. Following the recommendations of the PCBS, the Approved Person Regime was overhauled requiring statutory amendment. As such, the Financial Services (Banking Reform) Act 2013 (the “**Banking Reform Act**”) paved the way for enacting the required change by amending the Financial Services and Markets Act 2000 (“**FSMA**”) regarding the conduct of persons working in the financial services sector.

The SM&CR framework (consisting of three elements: (a) the senior managers regime (SMR); (b) the certification regime; and (c) the conduct rules) encourages individuals to take greater responsibility for their actions, which in turn should make it easier for both firms and the regulators, the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA), to hold individuals to account.

## Who does the SM&CR apply to?

The SM&CR came into effect from 7 March 2016 and is currently applicable to UK banks, building societies, credit unions and PRA-regulated investment firms and branches of foreign banks operating the UK (each a “**Firm**” or together the “**Firms**”). A PRA-regulated investment firm, as set out by the PRA, is a firm which:

- has, or has applied for, permission to deal in investments as principal;

- has, or would have if it were authorised, a minimum capital of EUR730,000, or is broadly analogous to a European Economic Area (EEA) passporting firm or non-EEA firm; and
- qualifies under the PRA's designation criteria.

Whilst the SM&CR is currently applicable to the Firms listed above, it is considered that it will be extended to all financial institutions in 2018 including investment firms, asset managers, mortgage brokers and consumer credit firms.

## The SMR

The SMR focuses on individuals performing a senior management function (SMF) on behalf of a Firm. According to the FSMA, "a function is a SMF, in relation to the carrying on of a regulated activity by an authorized person if (a) the function will require the person performing it to be responsible for managing one or more aspects of the authorized person's affairs, so far as relating to the activity, and (b) those aspects involve, or might involve, a risk of serious consequences for the authorized persons, or for business or other interests in the UK."

An individual carrying out a SMF shall be assigned a prescribed responsibility. This is to guarantee senior managers are accountable for responsibility to a specific area within the Firm. Examples of prescribed responsibilities as set by the FCA and PRA include:

- responsibility for the management of the allocation and maintenance of capital, funding and liquidity;
- responsibility for the Firm's recovery plan and resolution pack and overseeing the internal processes regarding their governance; and
- responsibility for monitoring effective implementation of policies and procedures for the induction, training and professional development of all persons performing SMFs.

However, before any individual can carry out a SMF they must be approved by the FCA and/or PRA. In order to assess the fitness and propriety of a senior manager for any given SMF, a statement of responsibility ("**Statement**") signed by the senior manager is required to be submitted along with their application to the regulators. The purpose of such Statement is to set out clearly which areas each senior manager is responsible for, and is meant to assist the regulators in connecting the failings in any given business area to specific individuals with responsibility. In addition, each Firm is obligated under the SMR to provide a management responsibilities map setting out the Firm's management and governance provisions.

## Certification Regime

The certification regime applies to employees of Firms who do not carry out a SMF but who nonetheless could cause a risk of significant harm to the Firm or any of its customers. Under the certification regime, there has been a departure from the previous APR in that it is now for Firms to certify on an ongoing basis that certain employees, referred to as ‘certified persons,’ are suitable to carry out such significant harm function, whereas under the APR approved persons were designated by the regulators.

## Conduct Rules

The conduct rules have been implemented to replace the Statements of Principal and Code of Practice for Approved Persons under the APR and are currently applicable to individuals subject to either the SMR or certification regime. To the extent Firms have not already considered or introduced the conduct rules more widely, it is intended for the conduct rules to be extended to the majority of employees by 7 March 2017 regardless of whether they hold a position of significant harm or not. The conduct rules are divided into two categories: first tier and second tier. The first tier rules are applicable to all individuals within a Firm and the second tier rules apply to senior managers only.

## Enforcement Action

The regulators may take enforcement action personally against any of the following for breach of a regulatory requirement: (1) a senior manager carrying out a SMF; (2) a certified person under the certification regime; and (3) any employee who is subject to the conduct rules. To take an enforcement action against an individual, the burden is on the regulators to prove that such individual has failed to take the steps that a reasonable person in the same position would have taken to prevent a regulatory breach from occurring. Any person who faces enforcement action by the regulators may be liable to a public censure identifying the individual concerned, an unlimited financial penalty and/or a prohibition order restricting its ability to hold certain positions in the future, such as a certified person function or SMF.

Furthermore, and in addition to facing civil enforcement, senior managers who cause a financial institution to fail may find themselves subject to criminal liability under the Banking Reform Act. To be liable, a senior manager must have:

- taken a decision or agreed to a decision on behalf of the Firm as to the way in which the Firm or any other financial institution that is a member of the Firm’s group is to be carried on;
- failed to take steps that could have prevented that decision from being taken;

- been aware at the time of the decision of the risk factors such that implementation of the decision may cause failure of the group institution; and
- acted in such a way that his/her overall conduct must fall below what could reasonably have been expected of someone in their position.

If these elements are proven, a senior manager on conviction on indictment could face up to a seven-year custodial sentence, a fine or both. On summary conviction, however, a senior manager guilty of this offence could face imprisonment for a term not exceeding twelve months, or six months if the offence was committed before the commencement of section 154(1) of the Criminal Justice Act 2003, a fine or both.

As discussed, it is evident the SM&CR has been implemented to enhance conduct and behaviour within Firms across all levels via the conduct rules; more importantly, the SM&CR aims to increase individual accountability amongst senior managers by aiming to ensure senior managers are held to account for their actions, and are no longer able to hide behind collective decision-making.