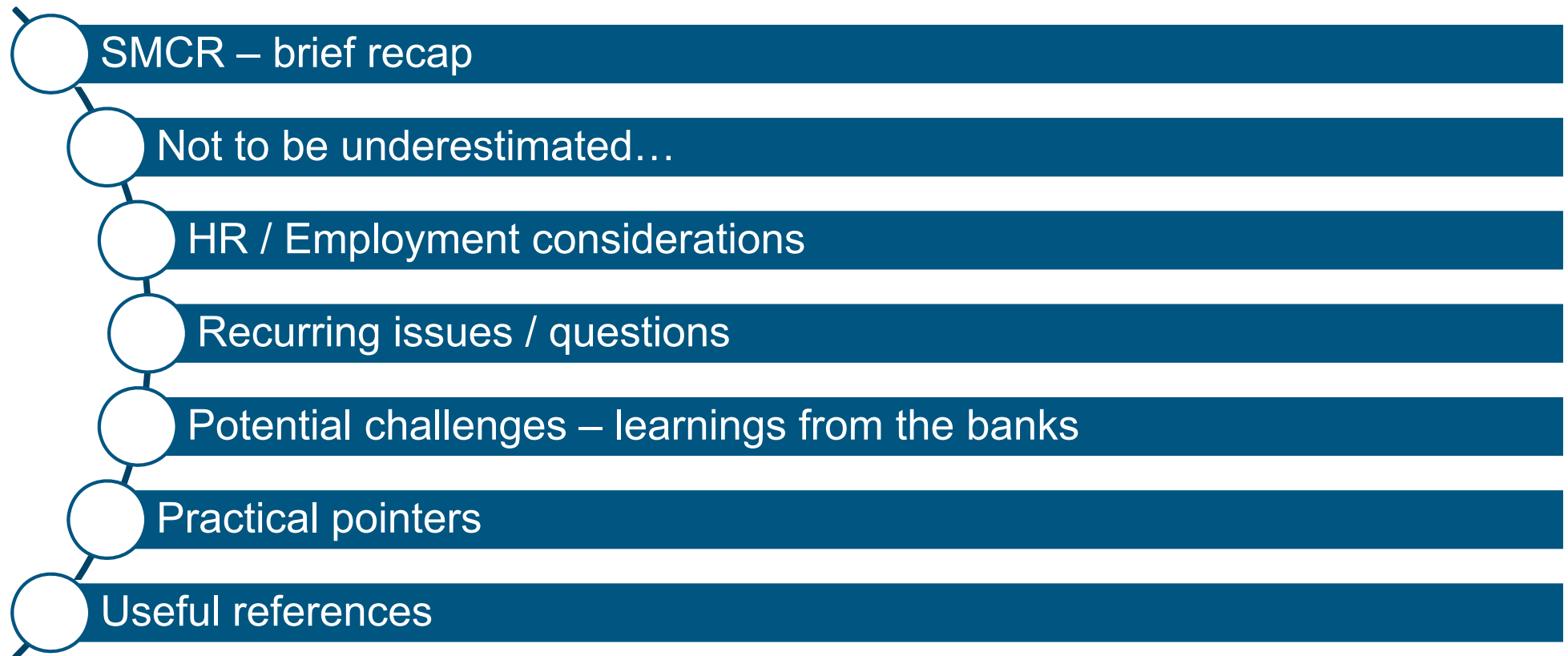


SMCR

Implementation Planning & Practicalities

LATHAM & WATKINS

OVERVIEW



OVERVIEW OF THE SMCR

The new regulatory framework for individuals (replacing the Approved Persons Regime), comprising of three key elements:

The Senior Managers Regime – approval regime for individuals performing “Senior Management Functions” (broadly, roles (potentially) involving a risk of serious consequences for the firm or business)

The Certification Regime – firms solely responsible for assessing the fitness and propriety of employees who could pose a risk of significant harm to the firm or its customers

The Conduct Rules – basic conduct standards applicable to most employees of the firm (save for purely administrative staff)

SMCR CLASSIFICATION



SUMMARY OF THE REGIME

| Senior Manager's Regime | | | | | | | |
|---------------------------------|---|--|----------------------------------|----------------------------|---|--|---|
| Senior Manager Conduct Rules | The most senior people in firms (broadly, at Board and ExCo levels). Anyone who performs a Senior Management Function must be pre-approved (as 'fit and proper') by the FCA. | | | | | | Fit and proper requirements (including Regulatory References) |
| | Core requirements: | | | | | | |
| | Senior Management Functions | Duty of Responsibility | Statement of Responsibilities | Criminal Records Checks | Prescribed Responsibilities (Limited Scope Firms don't need to do this) | | |
| | Extra requirements that only enhanced firms need to meet: | | | | | | |
| | Additional Senior Management Functions | Additional Prescribed Responsibilities | Responsibilities Maps | Handover Procedures | Overall Responsibility | | |
| Individual Conduct Rules | Certification Regime | | | | | | |
| | People who are not Senior Managers, but whose job can none the less cause significant harm to the firm or its customers. Firms must assess and confirm that these people are suitable to do their job (i.e. 'fit and proper') at least once a year. | | | | | | |
| | Other Staff | | | | | | |
| | All staff who perform financial services roles. This excludes ancillary staff (for example, caterers, cleaners, and security staff). | | | | | | |

TIMING

July 2017

First consultations on the detailed rules for the extended SMCR

December
2017

Further technical consultations on operational aspects of the extended SMCR, including forms and grandfathering

July 2018

Policy Statements and near-final rules published

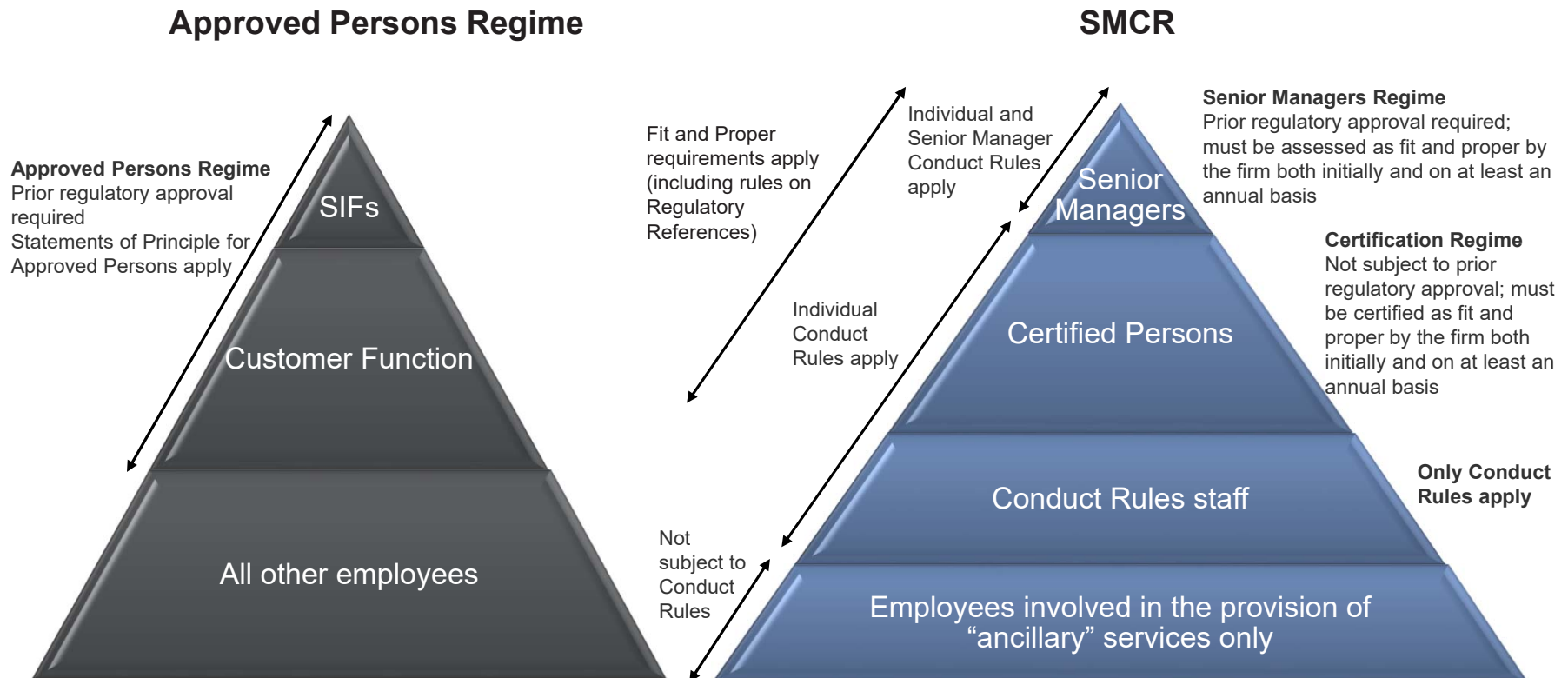
9 December
2019

Extended SMCR to come into force (“go-live”)

9 December
2020

End of transitional period for certifying staff

APPROVED PERSON REGIME V SMCR



SENIOR MANAGEMENT FUNCTIONS (UK FCA FIRMS)

| Senior Management Functions | | Core | Enhanced |
|----------------------------------|-------|------|----------|
| Chief Executive | SMF1 | X | X |
| Chief Finance | SMF2 | | X |
| Executive Director | SMF3 | X | X |
| Chief Risk | SMF4 | | X |
| Head of Internal Audit | SMF5 | | X |
| Group Entity Senior Manager | SMF7 | | X |
| Chairman* | SMF9 | X | X |
| Chair of Risk Committee* | SMF10 | | X |
| Chair of Audit Committee* | SMF11 | | X |
| Chair of Remuneration Committee* | SMF12 | | X |
| Chair of Nomination Committee* | SMF13 | | X |
| Senior Independent Director* | SMF14 | | X |
| Compliance Oversight | SMF16 | X | X |
| Money Laundering Reporting | SMF17 | X | X |
| Other Overall Responsibility | SMF18 | | X |
| Chief Operations | SMF24 | | X |
| Partner | SMF27 | X | X |
| Limited Scope Function | SMF29 | | |

* SMF ideally should be performed by a NED.

PRESCRIBED RESPONSIBILITIES (UK FCA FIRMS)

| Prescribed Responsibilities | Core | Enhanced |
|---|------|----------|
| Responsibility for the firm's performance of its obligations under the SMR | X | X |
| Responsibility for the firm's performance of its obligations under the employee certification regime | X | X |
| Responsibility for compliance with the requirements of the regulatory system about the management responsibilities map | | X |
| Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime | X | X |
| Responsibility for the firm's obligations in relation to conduct rules for: (a) training; and (b) reporting | X | X |
| Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of, the internal audit function in accordance with the internal audit requirements for SMCR firms | | X |
| Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of, the compliance function in accordance with the compliance requirements for SMCR firms | | X |
| Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of, the risk function in accordance with the risk control requirements for SMCR firms | | X |
| Responsibility for the firm's compliance with CASS | X | X |
| Responsibility for taking reasonable steps to ensure that every person involved in the performance of the firm's internal audit function is independent from the persons who perform external audit, including: (a) supervision and management of the work of outsourced internal auditors; and (b) management of potential conflicts of interest between the provision of external audit and internal audit services | | X |
| Responsibility for the development and maintenance of the firm's business model by the governing body | | X |
| Responsibility for: (a) managing the firm's internal stress tests; and (b) ensuring the accuracy and timeliness of information provided to the FCA and other regulatory bodies for the purposes of stress testing | | X |
| The responsibilities allocated under COLL 6.6.27R or 8.5.22R (Allocation of responsibility for compliance to an approved person) | X | X |

WHO IS CAUGHT UNDER CERTIFICATION REGIME

Code Staff under the Remuneration Codes

Anyone performing a Significant Management Function

Anyone performing the CASS oversight function

Certain proprietary traders

Individuals performing client-dealing or algorithmic trading activities

Individuals in customer-facing roles that are subject to qualification requirements

Anyone who supervises or manages a Certified Person directly or indirectly (if not a Senior Manager)

THE CONDUCT RULES

| Individual Conduct Rules (everyone except “ancillary staff”) | |
|--|--|
| Rule 1 | You must act with integrity |
| Rule 2 | You must act with due skill, care and diligence |
| Rule 3 | You must be open and cooperative with the FCA, the PRA and other regulators |
| Rule 4 | You must pay due regard to the interests of customers and treat them fairly |
| Rule 5 | You must observe proper standards of market conduct |
| Senior Manager Conduct Rules (Senior Managers only) | |
| SC1 | You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively |
| SC2 | You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system |
| SC3 | You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively |
| SC4 | You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice |

NOT TO BE UNDERESTIMATED...

- Initial gap analysis: the importance of getting it right
- Fitness & propriety framework
 - Likely to require concerted and effective functional coordination between (at a minimum) Compliance and HR
 - IT / systems capability and functionality
 - Ensuring the right data 'feeds'
 - Protocol for consistency of decisions
- On-boarding process
 - Incorporation of new requirements, such as employee certification, regulatory reference requests, induction training, Statements of Responsibilities, CRB checks etc
- Training
 - Obligation to provide suitably tailored training on the Conduct Rules (with assessment component) to all 3 tiers of in-scope staff
 - Outsource?

NOT TO BE UNDERESTIMATED...

- Scoping of the certified population
 - Often more difficult than identifying Senior Managers
- Human / political sensitivities and dynamics
- Regulatory references (both outward and inward)
- Role sharing
 - Sharing Senior Management Functions (and Prescribed Responsibilities) is meant to be the exception, not the norm, and needs to be explained / justified to the regulator. This will, invariably, give rise to a host of further questions / issues to be considered
- Matrix management complexities
- Legislating for 'grey' scenarios (e.g. a 'mixed' reference received or a marginal F&P case)

HR / EMPLOYMENT CONSIDERATIONS (1)

HR TOUCHPOINTS OVERVIEW



HR / EMPLOYMENT CONSIDERATIONS (2)

AMENDMENTS TO EMPLOYMENT CONTRACTS

| Conditions to employment/appointment to SMF or Certified Role | Duties | Termination provisions | Post-Termination |
|--|---|---|---|
| <ul style="list-style-type: none"> ▪ FCA approval for Senior Managers ▪ Criminal record checks ▪ Satisfactory regulatory reference from former employer ▪ Passing the firm's F&P assessment ▪ Completion of SMCR related induction programme ▪ Self-declaration of no previous, current or pending disciplinary investigations or actions (or other matters relevant to F&P) | <ul style="list-style-type: none"> ▪ Senior Managers: Perform duties specified in Statement of Responsibility & any Proscribed Responsibilities ▪ Maintain F&P assessment ▪ Attend all mandatory training ▪ Comply with applicable Conduct Rules and internal policies and procedures ▪ Notify the Firm of Conduct Rule breaches ▪ Comply with the Firm's handover policy | <ul style="list-style-type: none"> ▪ Up date summary dismissal / termination "for cause" to include: ▪ Receipt of negative updated regulatory reference ▪ Failing firm's annual F&P assessment ▪ Breach of Conduct Rules which compromises F&P (in Firm's assessment) | <ul style="list-style-type: none"> ▪ Co-operate with the Firm in relation to regulatory investigations post-termination ▪ Any commitment by firm to provide former SMs with access to records |

HR / EMPLOYMENT CONSIDERATIONS (3)

HOW TO IMPLEMENT CHANGES TO CONTRACTS?

- Update new joiner contracts
- Obtain employee agreement to contractual changes
- Risk of constructive dismissal claims

Consent



- Tie in with SMCR education /training
- Build into annual appraisal
- Allow time for questions / negotiation

Appraisal



- Year end bonus payment conditional on entering into new contract/contract addendum

Incentive



HR / EMPLOYMENT CONSIDERATIONS (4)

HIRING AND EXITS UNDER SMCR

Hiring

- Pre-employment checks
- Check regulatory reference
- Criminal record check
- FCA approval for SMs only

Terminations

- Handover policy
- Settlement agreement
- Regulatory reference
- On-going assistance
- FCA Notifications

Co-ordination

- Consistency is key
 - Ensure co-ordination between HR and compliance
 - After a SM departure – reallocate SMF or PRs
 - Revise Responsibilities Map (if applicable)
 - Revise job descriptions?
 - Update regulatory reference?
-

HR / EMPLOYMENT CONSIDERATIONS (5)

REGULATORY REFERENCES

- Hiring firms must obtain a regulatory reference on the proscribed form covering the past six years of employment for SMF and Certified Staff hires - even if former employer was not a regulated entity
- Upon request firms must provide a reference for former employees covering the past 6 years of employment (and any prior breaches of Conduct Rules or the Code of Practice for Approved Persons)
- Firms must respond to requests for regulatory reference within 6 weeks
- Regulatory reference must cover all information relevant to hiring firm's F&P assessment
- Settlement agreements must not contradict the regulatory reference rules
- Firms must retain records of former employees' conduct and F&P information for 6 years following termination
- Firm must update references issued in the past 6 years if new information comes to light which could impact the former employee's F&P assessment
- Firms must put in place policies and procedures to comply with regulatory reference requests and to update references previously issued

HR / EMPLOYMENT CONSIDERATIONS (6)

POLICY AND PROCEDURE UPDATES

- Recruitment procedure
- Induction programme
- Appraisal and performance management
- Regulatory reference policy/ protocol
- Whistleblowing policy
- Ethics & conduct policy
- Disciplinary policy
- Handover policy
- Personal record keeping policy?
- “Reasonable Steps” assurance framework?
- Breach notification policy
- D&O / indemnification policy

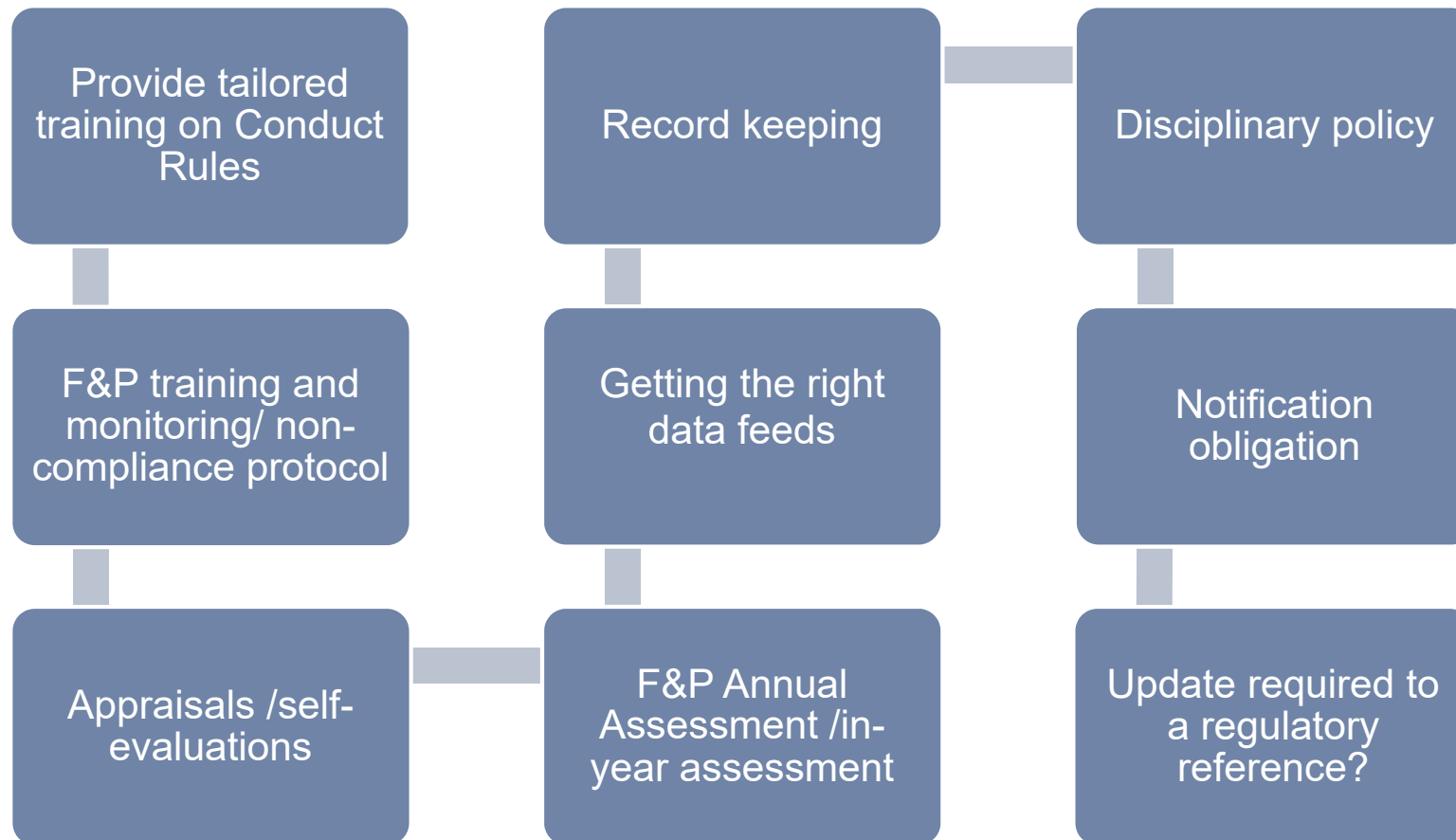
HR / EMPLOYMENT CONSIDERATIONS (7)

HANDOVER POLICIES

- Requirement on Enhanced Firms to take all reasonable steps to ensure that a person taking over an SM role has all the information and materials they would reasonably expect to discharge their duties and do the job effectively
- Firm should implement a handover policy requiring SMs to attend handover meetings & create handover notes for their successors
- Core firms are not required to do this – but could be helpful?
- What should the handover policy cover?
 - Responsibility for ensuring handovers are effected, reviewing handover notes, maintaining records
 - SM's responsibility to create a handover note/attend handover meeting(s)
 - Guidance on handover note content
 - Timing
- What should handover notes cover?
 - Tailored to the SM's specific role /responsibilities
 - Practical issues - not just a record of past events
 - Assessment of what issues should be prioritized going forward
 - Judgement and opinion, not just facts and figures

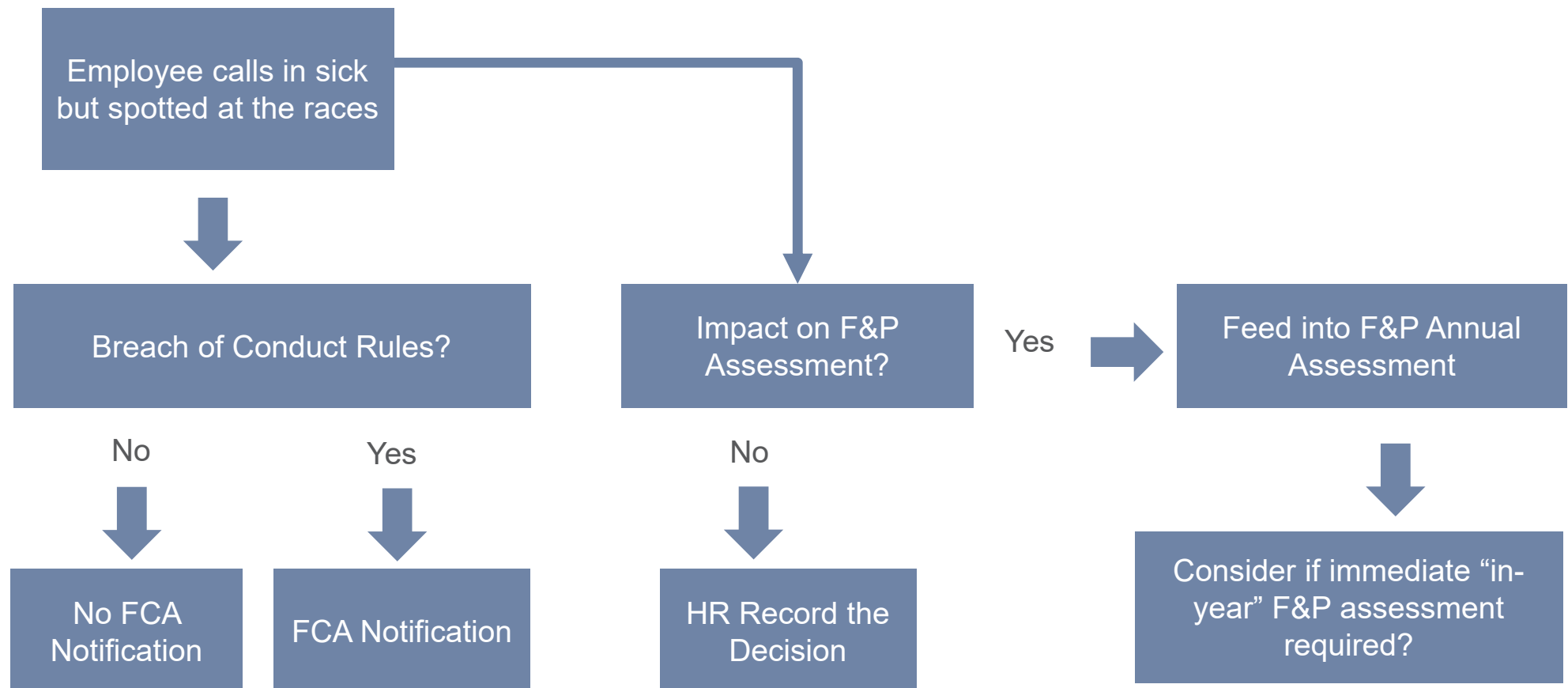
HR / EMPLOYMENT CONSIDERATIONS (8)

HR ONGOING COMPLIANCE WITH SMCR



HR / EMPLOYMENT CONSIDERATIONS (9)

WORKED EXAMPLE – DISCIPLINARIES AND SMCR



RECURRING ISSUES / QUESTIONS

- Initial 'house-keeping' exercise
- Portfolio management delegation model
- Fitness and propriety assessments
 - Who can / should make the decision?
- MRTs – a new category for firms not already subject to Remuneration Code requirements?
- Use of centralised functions across a group
- Third party outsourcing
 - Contractual requirement to comply with Core Conduct Rules?
- GDPR concerns
- Approach to 'reasonable steps'

POTENTIAL CHALLENGES – LEARNINGS FROM THE BANKS

| Area | Comment |
|---|--|
| Future-proofing / ongoing compliance | Must also focus beyond ‘day one compliance’ – very easy to become rapidly non-compliant if relevant triggers / action points not embedded into processes and controls from the outset |
| Systems / functional coordination | E.g. if HR becomes aware of a disciplinary issue, this should feed into the firm’s processes for Conduct Rule breach reporting and fitness & propriety assessments |
| Extraterritorial reach | Firms within international groups need to carefully consider whether any off-shore individuals will need to be approved or certified – it pays to undertake a thorough step-by-step analysis |
| Securing early (and continued) ‘buy-in’ from key stakeholders | CEO support / sponsorship will be invaluable. Key stakeholders will include HR, Compliance, Risk, Secretariat, Legal, IT and Management |
| Regulator ‘push-back’ | Most obviously, in relation to the clarity of Statements of Responsibility and choice of prospective Senior Managers (in certain circumstances) |

POTENTIAL CHALLENGES – LEARNINGS FROM THE BANKS

| Area | Comment |
|---|---|
| Documenting the thought-process behind a particular interpretation of the rules | Firms will, invariably, have to apply their own interpretations of the regulatory requirements. External counsel can play an important role |
| Reasonable steps guidance / oversight framework | Senior Managers may request practical guidance as to what their 'reasonable steps' and oversight frameworks should look like in practice (and the extent to which they need to be documented) |
| New / revised policies, protocols and procedures | For example, in relation to: breach notification assessments; references; and record-keeping |
| Determining 'house' positions | Formulation of agreed 'house' stance – e.g. in relation to: access to records (post-departure); payment for independent legal advice for Senior Managers |

PRACTICAL POINTERS

Do:

- Ensure you have a steering committee and project team in place to manage implementation
- Obtain senior buy-in at the outset
- Consider running an awareness and education programme to make sure there is sufficient understanding and appreciation of what is changing and what needs to be done
- Ensure timely involvement of, and co-ordination between, all key stakeholders
- Identify and map out new policies, processes, systems specifications and procedures required => comprehensive gap analysis
- Aim to streamline where possible – e.g. link annual fitness & propriety assessment to the appraisal process
- Plan for time to account for stakeholder buy-in, management sign-off, IT builds etc.

PRACTICAL POINTERS

Don't:

- Fail to plan properly, which could result in a failure to identify potential log-jams or issues in a timely manner
- Forget to keep up with developments as the regime takes shape, to ensure the end position meets regulatory expectations
- Fail to appreciate the underlying work required for various aspects of implementation
- Regard SMCR as a 'one-off' project – it isn't!
- Forget that elements of implementation may require more significant 'heavy-lifting'

PRACTICAL POINTERS

Consider:

- Adoption of certain requirements as a “global” standard across the firm/group?
- Core firms - voluntary application of certain elements of the Enhanced regime (e.g. handovers, responsibilities maps)?
- How to address the potential concerns of those becoming Senior Managers, for example access to records (including post-departure), indemnity insurance, and oversight frameworks / cascades
- How external advisers can help – from the ‘lightest touch’ input to comprehensive ‘hand-holding’
- Firms should prudently assume that they may well be subject to a post-implementation FCA inspection

USEFUL REFERENCES

- Latham & Watkins SMCR materials pack – available from natasha.kraus@lw.com
- SMCR: Guide for FCA solo-regulated firms (July 2018)
- SMCR: Proposed guidance on statements of responsibilities and responsibilities maps for FCA firms (October 2018)
- ‘Senior Individual Accountability in the Financial Services Arena – A Practical Guide’, Thomson Reuters
 - Reasonable steps
- Banking Standards Board (Statements of Good Practice and Supporting Guidance)
 - F&P assessments

THANK YOU

LATHAM & WATKINS



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