



THE SENIOR MANAGERS AND CERTIFICATION REGIME

Extension to all authorised firms

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CONTENTS

The Senior Managers and Certification Regime

INTRODUCTION	3
WHICH REGIME?	6
THE SENIOR MANAGERS REGIME	9
THE CERTIFICATION REGIME	15
REGULATORY REFERENCES	16
THE CONDUCT RULES	17
APPLICATION TO BRANCHES	18

INTRODUCTION

Background to and overview of the regime

The original Senior Managers and Certification Regime (SMCR) came into effect in March 2016 for most PRA-authorized firms (banks, building societies, credit unions, and PRA-designated investment firms). Even before this date, the UK government had announced that it planned to extend the regime to all authorized firms.

This guide provides an overview of the extended regime for FCA solo-regulated firms, which will come into force on 9 December 2019. The content is based upon the FCA's near-final rules in PS18/14 and PS18/15, which may be subject to change. The FCA and the PRA are also extending the SMCR to insurers; the regime for insurers is beyond the scope of this guide. Latham's separate guide on navigating implementation offers a practical perspective on the extended SMCR, and can be used as a framework for implementation planning.

Who does the extension affect?

The extension affects all FCA solo-regulated firms that are authorized under the Financial Services and Markets Act 2000. It also affects UK branches of both EEA and non-EEA firms. Branches will be subject to a modified, simpler version of the regime. Branches of EEA firms will be subject to the lightest touch variant (as under EU financial services legislation various matters are reserved to the home state regulator, limiting the requirements that may be imposed upon branches by the host state regulator).

The extended SMCR will not apply to other types of regulated financial services institutions that are not authorized under the Financial Services and Markets Act 2000, such as payment services firms.

What are the key aims of the regime?

When it comes into force, the extended SMCR effectively will replace the Approved Persons Regime.

The key aims of the SMCR are as follows:

- Encourage greater clarity of responsibilities and improved corporate governance
- Ensure that responsibility is not so thinly diffused that it can be readily disowned
- Focus the FCA's efforts on the people who really run the firm (i.e. senior management)
- Provide a sound framework for the FCA to take enforcement action against individuals when serious issues occur

Approach to the SMCR

SMCR implementation should not be regarded as a one-off project. Given the genesis and aims of the SMCR, firms will be expected to use it as a tool to assist with wider (and expected) ongoing culture change programmes. Firms are encouraged to embrace the spirit of the regime and not to take a "tick-box" approach to implementation.

How is the regime applied?

The SMCR applies on a legal entity basis. This may prove to be something of a challenge for those many firms or groups of firms that are run by business line or on a functional basis.

What does the regime look like?

The SMCR comprises of three elements:

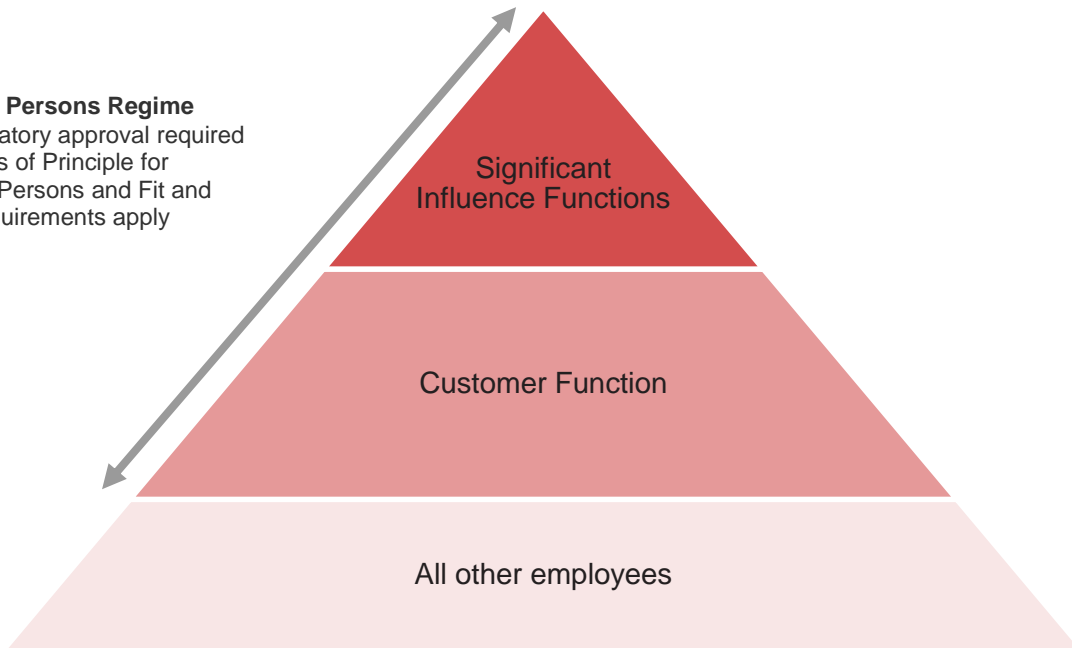
- **The Senior Managers Regime** – an approval regime for individuals performing Senior Management Functions (SMFs)
- **The Certification Regime** – firms are solely responsible for assessing the fitness and propriety of employees who could pose a risk of significant harm to the firm or its customers
- **The Conduct Rules** – basic conduct standards applicable to most employees of the firm (save for purely administrative staff)

INTRODUCTION continued

Background to and overview of the regime

Current: Approved Persons Regime

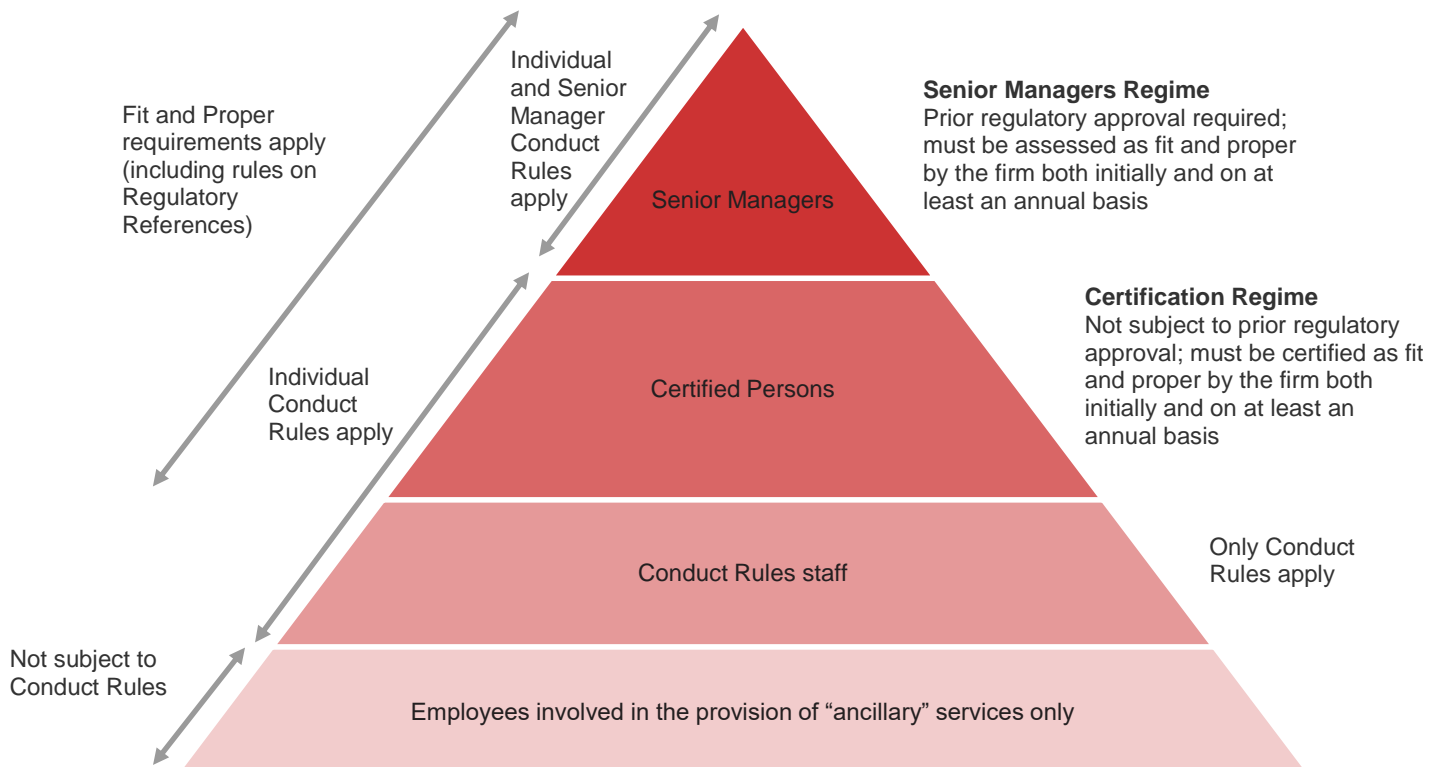
Approved Persons Regime
Prior regulatory approval required
Statements of Principle for
Approved Persons and Fit and
Proper requirements apply



New: Senior Managers and Certification Regime

Senior Managers Regime
Prior regulatory approval required;
must be assessed as fit and proper
by the firm both initially and on at
least an annual basis

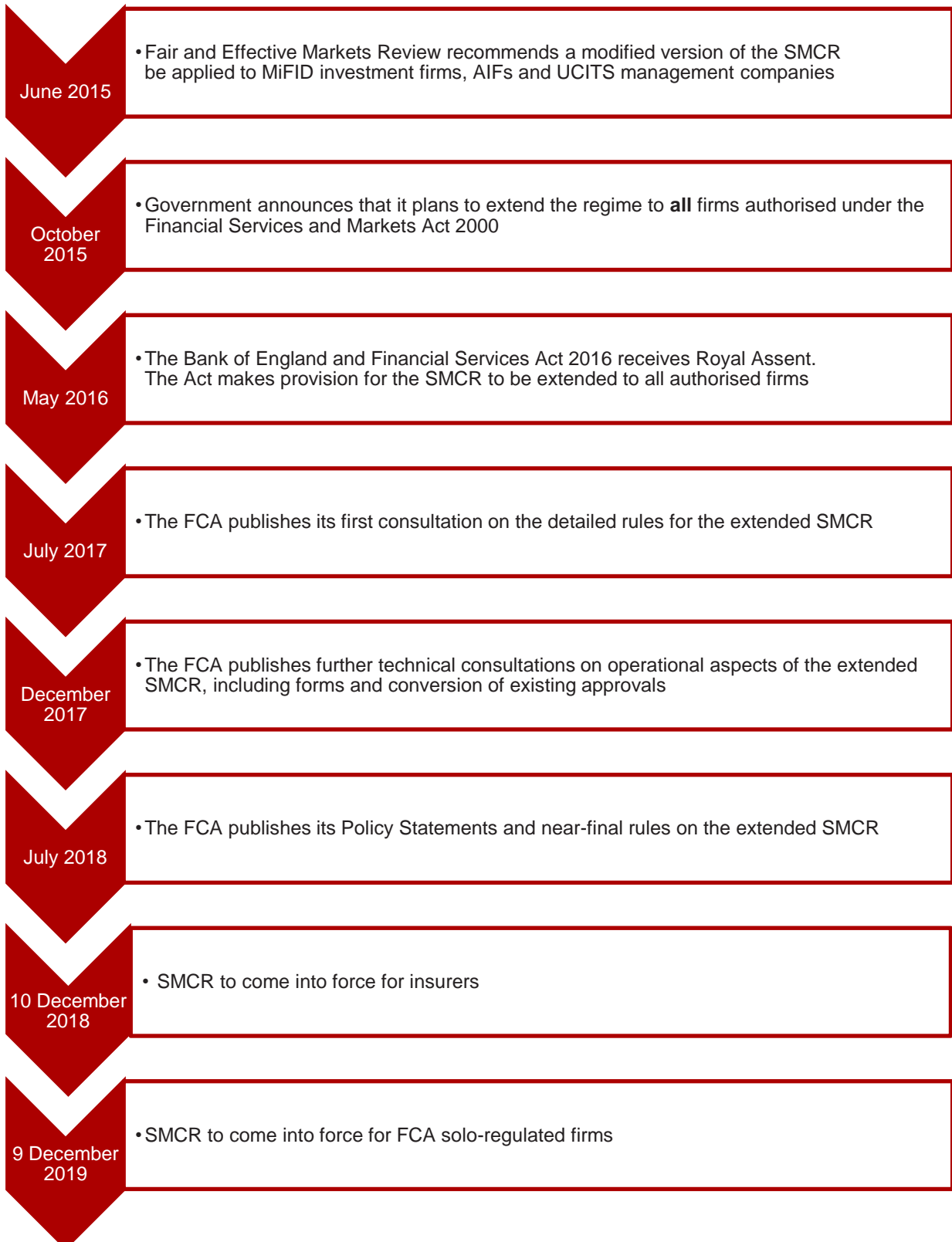
Certification Regime
Not subject to prior regulatory
approval; must be certified as fit
and proper by the firm both
initially and on at least an
annual basis



INTRODUCTION continued

Background to and overview of the regime

Timing of extension to all authorised firms



WHICH REGIME?

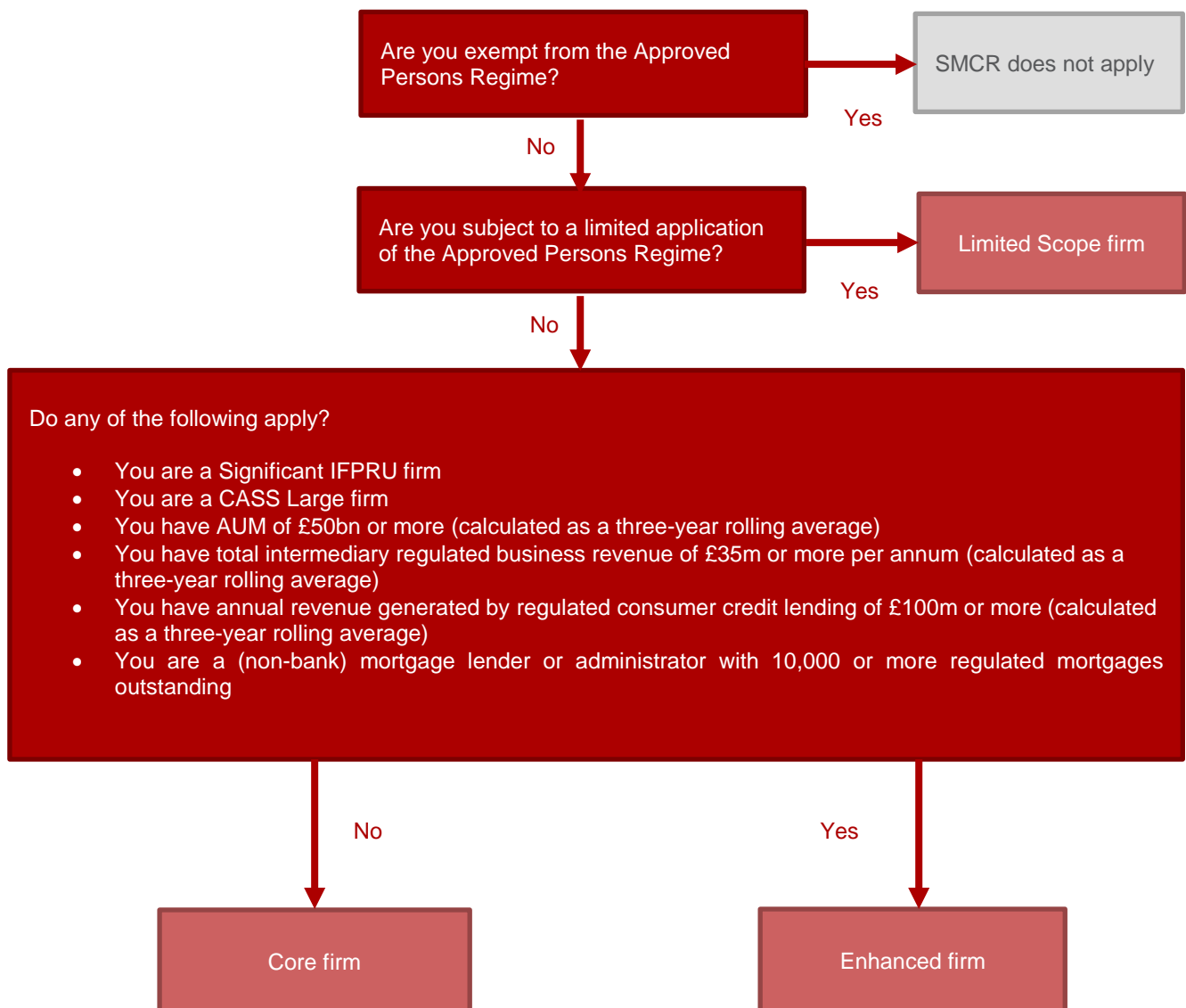
Are you Limited Scope, Core or Enhanced?

Classification

The FCA intends to apply the extended regime in a proportionate manner by dividing firms into three categories:

- **Limited Scope firms** – firms that currently benefit from a limited application of the Approved Persons Regime, such as sole traders, internally-managed AIFs and limited permission consumer credit firms, will be subject to a reduced set of requirements
- **Core firms** – firms that do not qualify as Limited Scope or Enhanced will be subject to the baseline regime, which is a pared-back version of the SMCR for banks
- **Enhanced firms** – around 350 of the largest, most complex, or riskiest firms will be subject to additional requirements above the Core baseline regime, more akin to the requirements for banks

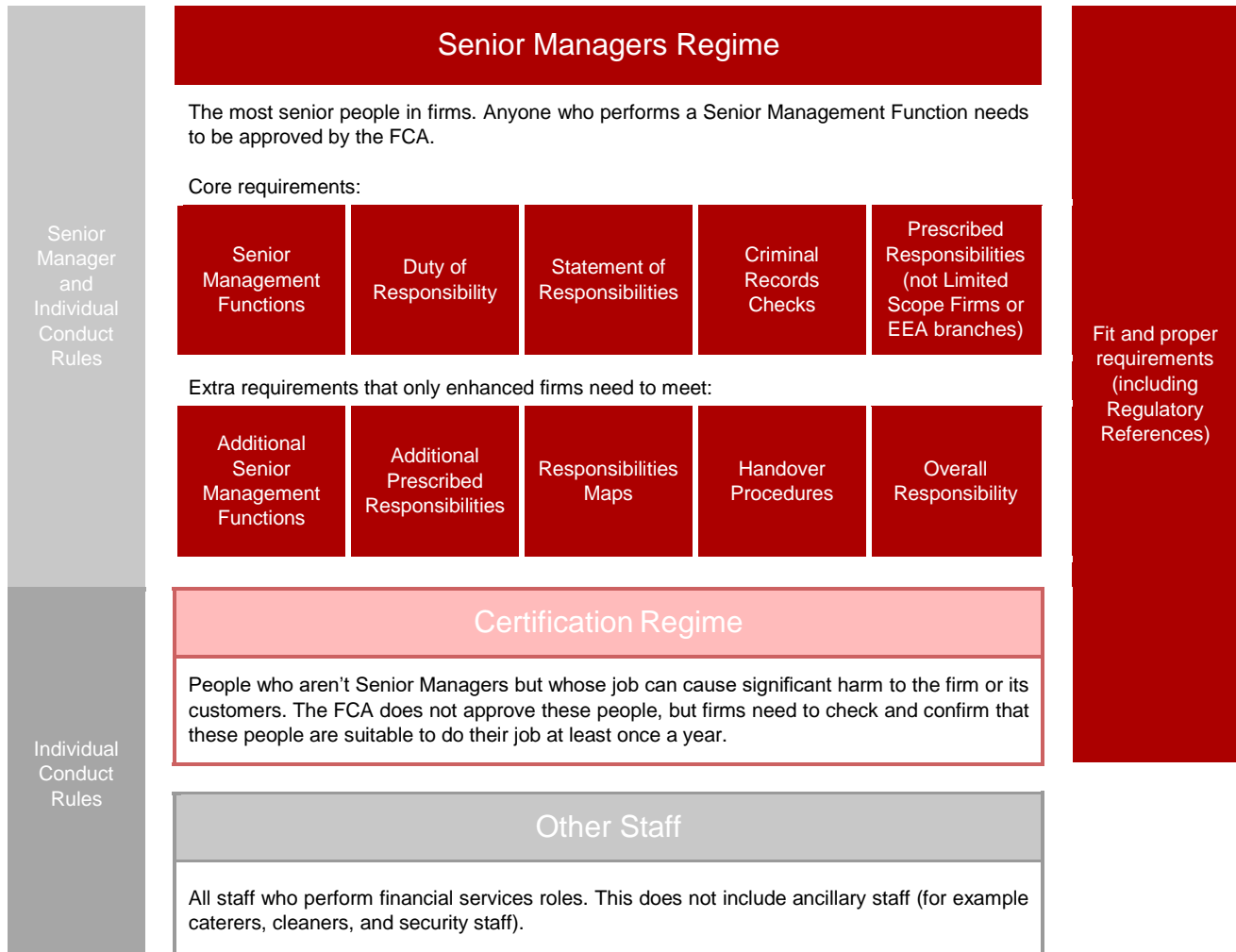
Summary guide to classification



WHICH REGIME? continued

Are you Limited Scope, Core or Enhanced?

Summary of the regime



WHICH REGIME? continued

Are you Limited Scope, Core or Enhanced?

What are the additional requirements for Enhanced firms?

- Additional Senior Management Functions
- Additional Prescribed Responsibilities
- Overall Responsibility requirement
- Responsibilities Maps
- Handover requirements

Can a firm be classified as Enhanced even if it does not fall within any of the specified categories?

In limited circumstances where a firm is large and complex, but does not meet any of the criteria for being an Enhanced firm, the FCA may require that firm to comply with the regime for Enhanced firms. This would be a case-by-case assessment; the FCA does not anticipate many firms being in this situation.

If a firm falls within the Core regime but considers that it is likely to fall within the Enhanced regime in future, or would rather comply with the Enhanced regime (perhaps to align with other group entities), it will be able to choose to apply the Enhanced regime by submitting a Form O. The opt-up will take effect three months after the firm submits the Form O. Firms should be aware, however, that if they wish to opt up formally, they will need to apply the Enhanced regime in its entirety (the FCA will not let firms pick and choose which elements to apply).

Also, firms wishing to apply the Enhanced regime voluntarily should be aware that, if they wish to move back down to the Core regime in future (provided that in the meantime they have not met any of the criteria for becoming an Enhanced firm), they will have to wait for one year after formally notifying the FCA of this intention before they can move back to the Core regime.

Can the FCA 'exempt' a firm from the Enhanced regime even though it meets the criteria for being an Enhanced firm?

Some firms will be exempt from the Enhanced regime under the rules, even if they meet one of the criteria. These include branches of overseas firms, certain full-scope UK AIFMs, and bidders in emissions auctions that are exempt from MiFID. It should be noted that a firm with a waiver from parts of the Significant IFPRU requirements only will be in scope of the Enhanced regime, whereas a firm with a waiver from being a Significant IFPRU firm entirely will not be in scope.

A firm that does not benefit from an exemption can apply for a waiver if it does not consider that the regime for Enhanced firms should apply. However, it is expected that it would be difficult (and therefore unusual) for a firm to obtain a waiver in practice.

Can firms move between different categories?

Yes, although the FCA wants to try to prevent firms moving between categories on a regular basis. The Enhanced regime will continue to apply to a firm for a period of one year once it stops meeting the relevant criteria (the exact timing of when this period commences depends on which criterion applies).

Once a Core firm meets one of the relevant criteria for the Enhanced regime, it will have one year before it has to comply with the Enhanced regime (again, the exact timing of when this period commences depends on which criterion applies).

THE SENIOR MANAGERS REGIME

New framework for those at the top

The Senior Managers Regime (SMR) seeks to afford a clear allocation of responsibilities to the most senior individuals within a firm, and strengthen their level of responsibility and accountability through:

- A robust initial and ongoing assessment of their fitness and propriety, by both the firm and the FCA
- Strengthened powers for the FCA relating to approvals (the approval process will no longer be binary; approval may be granted subject to conditions or time limits) and enforcement

In practice, a firm is likely to have fewer individuals approved as Senior Managers than it currently has approved as Significant Influence Function holders under the Approved Persons Regime.

Who is caught by the SMR?

The statutory definition of a Senior Management Function (SMF) refers to a function performed in relation to the carrying on of a regulated activity by a firm, which requires the person performing it to be responsible for managing one or more aspects of the firm's affairs, where those aspects involve, or might involve, a risk of serious consequences for the firm, or for business or other interests in the UK.

The table on page 11 shows which SMFs are potentially applicable to each type of firm within the extended SMCR.

It is important to note that the SMR applies on a legal entity (not business line or functional) basis – therefore firms must consider an individual's role in relation to the regulated entity in question.

There is also no territorial limitation on the SMR, so the regime applies to anyone who performs an SMF, regardless of whether or not they are based in the UK.

The table on page 10 shows the differences between the Approved Persons Regime and the SMR (for completeness, the table shows all SMFs under the SMR, but not all of these SMFs will be relevant to any given firm).

Certain roles requiring regulatory approval under the Approved Persons Regime (for example, the Customer Function) fall within the Certification Regime under the SMCR framework.

What is the approach to NEDs?

Not all NEDs are within scope of the SMR. For Core firms, the only SMF ideally to be allocated to a NED is the Chairman function (SMF9) (although the FCA states that this role may be fulfilled by an individual in an executive or non-executive position). For Enhanced firms, there are a number of SMFs that should ideally be performed by NEDs (see the table on page 11).

NEDs that do not fall within the SMR are nevertheless subject to the Individual Conduct Rules and Senior Manager Conduct Rule 4, the fitness and proprietary requirements, and the rules on regulatory references.

Key points

- There is no prescribed number of Senior Managers; some SMFs are compulsory, but others only apply if relevant.
- Generally speaking, the larger and more complex the firm, the more Senior Managers there will be.
- Individuals can in principle perform more than one SMF, where appropriate (subject to existing restrictions and independence requirements).
- SMFs can be shared but not split; each individual remains fully responsible for the whole function, and any job-sharing arrangements need to be explained to the FCA.

THE SENIOR MANAGERS REGIME continued

New framework for those at the top

Comparison of Functions under the Approved Persons Regime (old) and the SMR (new) (including SMFs relevant to banks, insurers and branches)

Approved Persons Regime - Controlled Functions		Senior Managers Regime - Senior Management Functions	
Director	CF1	Chief Executive	SMF1
Non-executive Director	CF2	Chief Finance	SMF2
Chief Executive	CF3	Executive Director	SMF3
Partner	CF4	Chief Risk	SMF4
Director of Unincorporated Association	CF5	Head of Internal Audit	SMF5
Small Friendly Society	CF6	Head of Key Business Area	SMF6
Apportionment and Oversight	CF8	Group Entity Senior Manager	SMF7
Compliance Oversight	CF10	Credit Union Senior Manager	SMF8
CASS Operational Oversight	CF10A	Chairman	SMF9
Money Laundering Reporting	CF11	Chair of Risk Committee	SMF10
Benchmark Submission	CF40	Chair of Audit Committee	SMF11
Benchmark Administration	CF50	Chair of Remuneration Committee	SMF12
Systems and Controls	CF28	Chair of Nomination Committee	SMF13
Significant Management	CF29	Senior Independent Director	SMF14
Customer	CF30	Chairman of the With-Profits Committee	SMF15
		Compliance Oversight	SMF16
		Money Laundering Reporting	SMF17
		Other Overall Responsibility	SMF18
		Head of Third Country Branch	SMF19
		EEA Branch Senior Manager	SMF21
		Other Local Responsibility	SMF22
		Conduct Risk Oversight (Lloyd's)	SMF23b
		Chief Operations	SMF24
		Partner	SMF27
		Limited Scope Function	SMF29

THE SENIOR MANAGERS REGIME continued

New framework for those at the top

Application of Senior Management Functions by firm type (UK solo-regulated firms only)

Senior Management Functions		Limited Scope**	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	X
Money Laundering Reporting	SMF17	X	X	X
Other Overall Responsibility	SMF18			X
Chief Operations	SMF24			X
Partner	SMF27		X	X
Limited Scope Function	SMF29	X		

* SMF ideally should be performed by a NED.

** Note that for insurance mediation and consumer credit Limited Scope firms, only SMF29 is relevant. For sole traders with no employees, only SMF16 is relevant. In very limited circumstances, the governing functions (SMFs 1, 3, 9, 27) may be relevant to a sole trader or authorised professional firm.

THE SENIOR MANAGERS REGIME continued

New framework for those at the top

Allocation and documentation of responsibilities

Clear allocation of responsibilities is a key tenet of the SMR. The responsibilities framework under the SMR requires the production of various interrelated documents. A key challenge is ensuring that all documents are consistent, kept up to date, and that records of current and previous versions are maintained. It is also crucial for firms to check that there are no gaps in responsibility or accountability.

The responsibilities framework operates as follows:

- Senior Managers must be allocated any relevant “Prescribed Responsibilities” (Core and Enhanced firms) – not all of these are mandatory and some only apply if relevant to the firm
- Enhanced firms also have an overall responsibilities obligation – to ensure that a Senior Manager has overall responsibility for every activity, business area and management function across the firm
- Despite there being some flexibility around allocations, in practice certain Prescribed Responsibilities should be allocated to individuals performing certain SMFs, and certain Prescribed Responsibilities should ideally be allocated to NEDs
- Each Senior Manager must have a Statement of Responsibilities (SoR), which must be pre-approved by the FCA
- Firms must use a template SoR to set out both any Prescribed Responsibilities allocated to the individual, plus any other relevant responsibilities
- The SoR is meant to be concise and factual, self-contained, and should not contain anything that dilutes, qualifies or undermines the allocated Prescribed Responsibilities
- The SoR must be updated and resubmitted whenever there is a “significant change”
- For Enhanced firms, SoRs are complemented by the firm’s Responsibilities Map, which is designed to reflect the firm’s overall governance and management arrangements, and to ensure that there are no accountability gaps

Notably, the proposed lists of Prescribed Responsibilities for Core and Enhanced firms under the extended SMCR are shorter than the list for banks. For instance, they do not include the Prescribed Responsibilities relating to the firm’s culture.

The Duty of Responsibility

Senior Managers will have a statutory “duty of responsibility”. A Senior Manager may be found guilty of misconduct if the FCA can prove that the Senior Manager did not take reasonable steps to prevent a regulatory contravention in an area for which he or she is responsible from occurring or continuing. The FCA has published guidance on the duty of responsibility for banks, and will apply this guidance to all firms.

A Senior Manager can also be held to account by the FCA for a breach of the Conduct Rules, in circumstances where the individual is “personally culpable” (i.e. his or her conduct was below that which would be reasonable in all of the circumstances). Senior Manager Conduct Rule 2 requires Senior Managers to take reasonable steps to ensure that the business of the firm for which they are responsible complies with the relevant requirements and standards of the regulatory system. In practical terms, it would appear that there is little substantive difference between the duty of responsibility and Senior Manager Conduct Rule 2.

THE SENIOR MANAGERS REGIME continued

New framework for those at the top

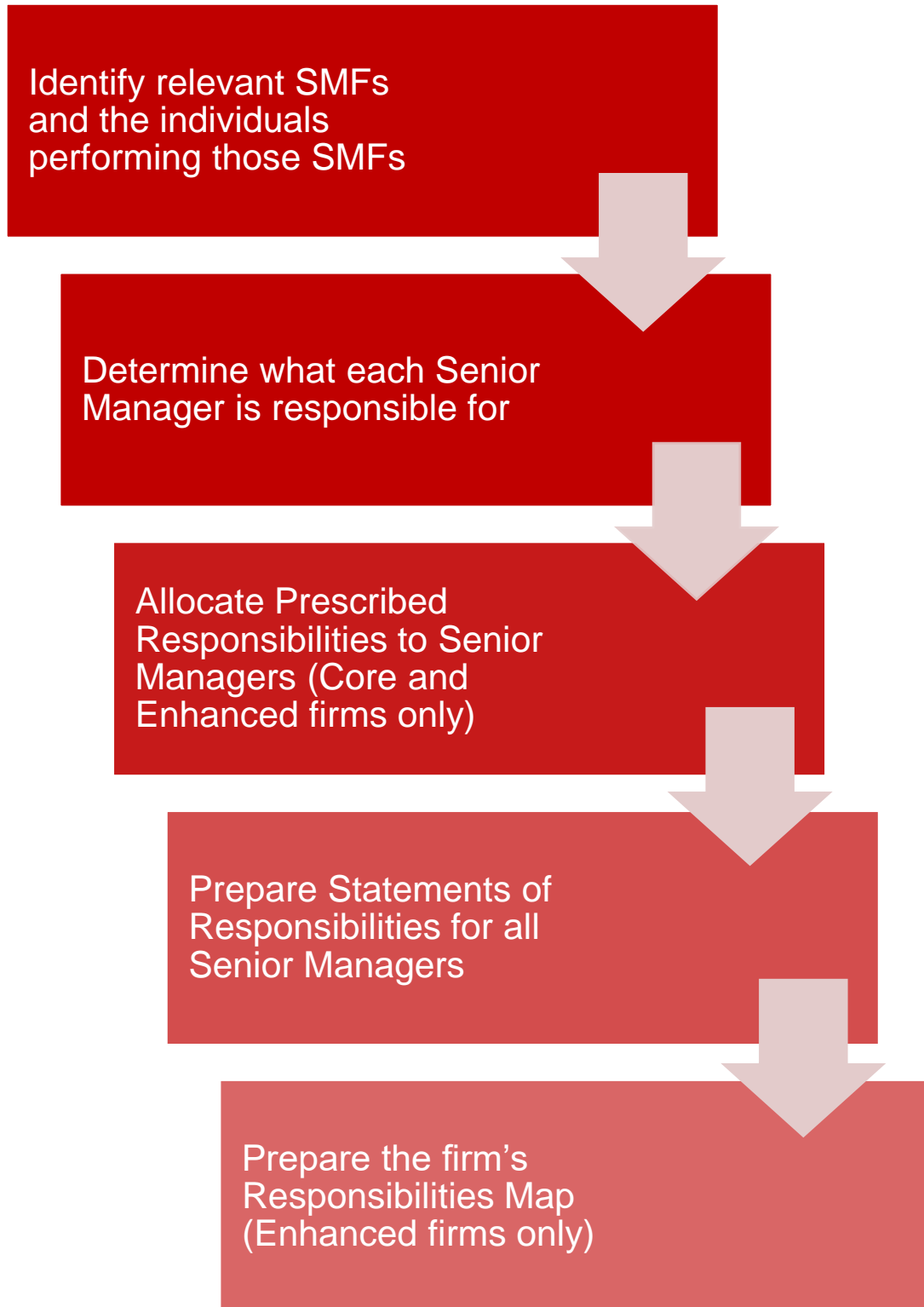
Table of Prescribed Responsibilities by firm type (UK solo-regulated firms only)

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

THE SENIOR MANAGERS REGIME continued

New framework for those at the top

Overview of SMR implementation



THE CERTIFICATION REGIME

Responsibility lies with the firm to assess fitness and propriety

Captures employees who fall outside the SMR, but who are performing functions that involve them in aspects of the firm's affairs that might involve a risk of significant harm to the firm or its customers

No prior regulatory approval is required, but the firm must certify that the individual is fit and proper to perform the role in question, both initially and at least annually thereafter

Responsibility for the firm's compliance with the Certification Regime must be allocated to a Senior Manager (except for Limited Scope firms)

The Certification Regime captures:

- Anyone performing a Significant Management function
- Anyone performing the CASS oversight function
- Certain proprietary traders
- Individuals performing client-dealing activities
- Individuals performing algorithmic trading activities
- Individuals in customer-facing roles that are subject to qualification requirements
- Individuals who are Code Staff for the purposes of the FCA's Remuneration Codes
- Anyone who supervises or manages a Certified Person directly or indirectly (if not a Senior Manager)

The FCA will include a territorial limitation in relation to all individuals except Remuneration Code Staff. This means that an individual would not fall within the Certification Regime unless he or she is based in the UK, or dealing with clients in the UK (although "dealing with" in this context has an extended meaning broadly akin to "any client contact").

REGULATORY REFERENCES

New, more prescriptive rules to be applied to all firms

The enhanced rules for regulatory references that currently apply to banks will be extended to all authorised firms.

These were introduced following recommendations by the Fair and Effective Markets Review, and are designed to help prevent individuals with poor disciplinary records moving from one firm to another without relevant information about their disciplinary history being disclosed.

What are the key features of the new rules?

Firms will be required to:

Request a reference from all previous employers in the past six years for all candidates applying for Senior Manager, Certification and NED roles (including NEDs outside the scope of the SMR).

Use a standard reference template for regulatory references, which requires firms to answer certain questions and therefore makes it more difficult to avoid disclosure

Disclose certain information going back six years, including details of any disciplinary action taken as a result of Conduct Rule breaches

Disclose any other relevant information about the fitness and propriety of the candidate going back six years, plus information about any serious misconduct that has occurred at any time

Retain records relating to disciplinary matters and fitness and propriety that are sufficient to meet the regulatory reference obligations

Update references where new, significant information comes to light in the six years after the individual ceases to be employed by the firm (which may entail working out who currently employs the individual, if they have moved firms more than once)

THE CONDUCT RULES

Basic standards applicable to most employees of the firm

The Conduct Rules will apply in two tiers – some will apply across almost everyone working for the firm, whereas others will apply to Senior Managers only.

The Individual Conduct Rules are very similar to the Statements of Principle for Approved Persons, but will apply to a much broader range of individuals – everyone in the firm except “ancillary staff” (for example, cleaners, caterers).

This has implications for the employee lifecycle (on-boarding, training, appraisals, disciplinary processes). It also means that the FCA will, in principle at least, be able to take disciplinary action against a wider range of individuals within the firm.

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

Firms will have three key obligations in respect of the Conduct Rules:

- Inform staff about the Conduct Rules
- Provide training to staff on the rules (including on what the rules mean for them specifically). Training must be tailored to the audience and their role
- Notify the FCA when they have taken disciplinary action (broadly defined, and including the issuing of a formal written warning, the suspension or dismissal of the individual, or the reduction or recovery of the individual's remuneration) against an individual for a breach of the Conduct Rules. Appropriate systems and processes need to be devised so that relevant information is recorded and escalated to the right people within the firm. Notifications will need to be made within prescribed timeframes, depending on whether the breach involves a Senior Manager, Certified Person, or other Conduct Rules staff

APPLICATION TO BRANCHES

Branches of overseas firms to be subject to a modified regime

As with the SMCR for banks, UK branches of overseas firms will be subject to a modified version of the SMCR.

The way in which the regime will apply depends on whether the branch is part of an EEA firm or a non-EEA firm. The regime will apply in a particularly limited way in relation to UK branches of EEA firms, as many matters are reserved to the Home State regulator under EU financial services legislation. The Enhanced regime will not be applicable to branches.

The Certification Regime and Conduct Rules will apply to UK branches of both EEA and non-EEA firms, although they will only apply to individuals based in the UK.

Applicable SMFs

Senior Management Functions		EEA Branch (Core and Limited Scope)	Non-EEA Branch (Core)	Non-EEA Branch (Limited Scope)
Executive Director	SMF3		X	X
Compliance Oversight	SMF16		X	X
Money Laundering Reporting	SMF17	X	X	X
Head of Third Country Branch	SMF19		X	X
EEA Branch Senior Manager	SMF21	X		
Limited Scope Function	SMF29			X

Relevant Prescribed Responsibilities

Note that Prescribed Responsibilities are only relevant to non-EEA Branches within the Core Regime.

- Responsibility for the firm's performance of its obligations under the SMR
- Responsibility for the firm's performance of its obligations under the employee certification regime
- Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime
- Responsibility for the firm's obligations in relation to conduct rules for: (a) training; and (b) reporting
- Responsibility for the firm's compliance with CASS
- The responsibilities allocated under COLL 6.6.27R or 8.5.22R (Allocation of responsibility for compliance to an approved person)
- Responsibility for management of the firm's risk management processes in the UK
- Responsibility for the firm's compliance with the UK regulatory system applicable to the firm
- Responsibility for the escalation of correspondence from the PRA, FCA and other regulators in respect of the firm to the governing body and/or the management body of the firm or, where appropriate, of the parent undertaking or holding company of the firm's group.

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