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The clock is ticking – will you be ready?

Extension of the Senior Managers and Certification Regime

June 2019

Contents

1. Introduction

From 9 December 2019, the Senior Managers and Certification Regime (SMCR) will apply to all Financial Services and Markets Act (FSMA) authorised firms, including banks, building societies, asset managers, investment firms, insurers, mortgage providers, consumer credit firms and sole traders. All regulated firms will be required to implement and adhere to the Financial Conduct Authority's (FCA's) rules on individual accountability.

This paper replaces our 2017 paper entitled 'Coming full circle – Extension of the Senior Managers and Certification Regime' and provides targeted guidance for FCA solo-regulated firms preparing for commencement of the regime.

Background

The SMCR represents a complete overhaul of the Approved Persons Regime following the recommendations of the Parliamentary Commission on Banking Standards (PCBS). The PCBS was established in June 2012, to consider the professional standards and culture of the UK banking sector after the financial crisis of 2007-2008.

The recommendations proposed establishing a new regulatory framework to:

- focus accountability on a narrower number of the most senior individuals;
- encourage individuals to take greater responsibility for their actions; and
- make it easier for firms and regulators to hold individuals to account.

The Government initially prioritised the banking sector for reform as the PCBS was concerned that extending the recommendations to all financial services firms would delay implementation. Accordingly, the SMCR commenced on 7 March 2016 for banking firms.

The Government announced in 2015 that all regulated firms would be subject to the regime. The Fair and Effective Markets Review Report published in June 2015 supported the extension. It concluded that making participants in fixed income, currency and commodity markets subject to the regime would serve to strengthen standards and reduce the risk of poor conduct in these markets by increasing individuals' personal accountability and mandating individuals to have regulatory references.

In addition, the FCA's Asset Management Market study from June 2017 highlighted the SMCR as an important part of enhancing governance for firms in this sector.

The FCA's near final rules (Policy Statement (PS) 18/14)[1] and guidance[2] were published in July 2018. Since then, the regime has been extended to all dual-regulated (FCA and Prudential Regulatory Authority (PRA)) insurers (which became subject to the regime from 10 December 2018).

Now it is time for the 47,000 FCA solo-regulated firms captured by the regime to prepare. The extension of the SMCR seeks to unify the standards applied to all financial services firms and apply a consistent approach throughout the industry.

"The purpose of this is to embed responsibility and accountability. Senior Managers should know what they are responsible for, as should key Board members."

Andrew Bailey, Chief Executive of the FCA, 16 March 2017

1. https://www.fca.org.uk/publication/policy/ps18-14.pdf
2. https://www.fca.org.uk/publication/policy/guide-for-fca-solo-regulated-firms.pdf

The shift to individual accountability

Since the financial crisis, there have been many instances of firms being held to account by regulators for management failings, but far fewer instances of individual managers being held to account.

In part, this can be attributed to the fact that regulators had difficulty linking control failings to specific Senior Managers due to the nature of collective decision-taking. As there has previously been no requirement to define and formally inform the regulators who is responsible for what in a firm, it was possible for individuals to claim (in the case of a failing) that the business area or management function was someone else's responsibility, or that a decision was taken collectively. Regulators were alert to the potential for 'individuals seeking to protect themselves on a 'Murder on the Orient Express' defence (it wasn't me, it could have been anyone)' as noted by Martin Wheatley, former Chief Executive of the FCA in his speech 'Nothing to fear from high standards' in March 2015.

Implementing the SMCR

Whilst the requirements of the extended regime are near final in most respects, they are still subject to commencement regulations to be made by HM Treasury. However, the FCA notes that firms affected by these changes will move to the new regime on 9 December 2019. Therefore, FCA solo-regulated firms need to ensure that they understand how the changes will affect their business and should already be working on implementation.

We are currently supporting a range of FCA solo-regulated firms with their implementation programmes and we have worked with a number of banks and insurance firms in implementing SMCR over the past five years. This paper provides insights into the new regime based upon our extensive experience including:

- an overview of the regime requirements outlined in the FCA near-final rules and guidance;
- lessons learned from our experience implementing the SMCR within the banking and insurance sectors; and
- key tasks that firms need to focus on to ensure that they are ready for commencement of the regime.

The extension of the SMCR captures the full range of firms from the very smallest to large multinationals. This paper recognises that the approach each firm takes to implementing the SMCR should be proportionate to the size, complexity and nature of its business but largely focuses on the impact for core and enhanced firms which will have the most significant implementation challenges.

2. Executive summary

Who should read this document?

The SMCR will have a market- and firm-wide effect. However this paper will be of most use to Senior Managers seeking to understand the implications of the new regime (for example, Executive and Non-Executive Board members), as well as the individuals responsible for implementation programmes (e.g. Compliance, Risk, Human Resources, Legal and Company Secretariat).

Why has the SMCR been extended?

The extension of the SMCR to all FSMA authorised firms aims to foster a culture of greater individual accountability. It will increase individual responsibility at the most senior levels and ultimately seeks to help restore confidence in the financial services industry.

When will it be implemented?

PS 18/14 sets out that, following HM Treasury endorsement, the final rules will come into force for FCA solo-regulated firms from 9 December 2019. Firms will then have until 9 December 2020 to assess Certified Staff as fit and proper and issue certificates as well as train Other Conduct Rules Staff. In addition, by 9 December 2020 FCA solo regulated firms must also upload their data to the Directory.

What are the implications?

The SMCR completely replaces the current Approved Persons Regime and introduces a number of new concepts to increase individual accountability within financial services firms. In the next section of this paper we set out in detail the proposed changes that FCA solo-regulated firms will have to undertake and embed ahead of the implementation deadline.

If individuals seek very precise definitions of responsibility and firms record decisions in increasingly minute detail it can on one hand safeguard firms against potential future action, but on the other, it may stifle debate and challenge. It will therefore be important that firms and individuals take a pragmatic approach to the requirements of the new regime.

Has anything changed since CP 17/25[3]?

Whilst PS 18/14 confirms the near-final rules and Guidance, the FCA has also consulted on and confirmed its position on a number of specific elements of the SMCR, including:

- The Directory – a public register which will allow consumers and firms to check the status and history of people working in the financial services sector;
- Further guidance for firms on Statements of Responsibilities and Management Responsibilities Maps for FCA firms; and
- Additional clarity on Overall Responsibility and the position of the Legal function in the SMCR. FCA CP 19/4[4] on Overall Responsibility and the Legal function remains open and we expect the FCA's final position to be confirmed later in 2019.

SMCR and Culture

The FCA has repeatedly stated that Culture and Governance should be a top priority for firms and has indicated that it sees SMCR as a lever for the potential cultural transformation of the financial services industry.

It may therefore have surprised some firms to see that the two PRA Prescribed Responsibilities for culture were not included in the extension of the SMCR to FCA solo-regulated firms (although they remain for banks and insurers).

In PS 18/14 the FCA confirmed that it has not introduced a PR for culture as the FCA considers every individual in a firm to be accountable for the firm's culture, from the governing body down. This reinforces the FCA's own focus on culture and governance.

Whilst culture will be reinforced through the application of the Conduct Rules, the FCA expects that Boards should be collectively responsible for setting and monitoring firms' cultures. Boards therefore need to ensure culture remains high on their agenda and be able to demonstrate how they satisfy themselves that the firm's culture does not cause harm.

"The regime embraces a very simple proposition – a senior manager ought to be responsible for what happens on his or her watch. That is what shareholders, consumers as well as the FCA really want. The challenge of responsibility – and suppressing the instinct to evade responsibility – is a cultural one."

Mark Steward, Director of Enforcement and Market Oversight at the FCA, 19 January 2017

3. https://www.fca.org.uk/publication/consultation/cp17-25.pdf
4. https://www.fca.org.uk/publications/consultation-papers/cp19-4-optimising-senior-managers-certification-regime-and-feedback-dp16-4

What should firms do now?

Early engagement is crucial in ensuring that firms are thoroughly prepared for the extension of the regime. Firms will need to consider the FCA near final rules and guidance (PS 18/14) as well as the FCA's final guidance on Statements of Responsibilities and Responsibilities Maps (FG 19/2)[5], what these mean to their business model and ensure that their programme covers all relevant steps needed to thoroughly prepare. It is imperative that firms do not underestimate the amount of work required to ensure compliance with the new regime.

Whilst at present the rules contained in PS 18/14 are 'near-final' in most respects, they should only be amended where the FCA requires changes to its Handbook (e.g. in the case of the UK's exit from the European Union, or further SMCR optimisations), and therefore we would expect the principles and rules set out in the Policy Statement to remain largely unchanged prior to commencement of the regime. This is based on our experiences from the banking and insurance sectors in which those firms that delayed preparation until final rules were published found significant challenges in meeting the regulatory requirements on time.

5. https://www.fca.org.uk/publication/finalised-guidance/fg19-02.pdf

3. Overview of the incoming changes

Will my firm be affected?
The extended SMCR will cover a diverse and extensive range of firms. Taking this into account the FCA has proposed a proportionate and flexible approach, categorising firms and subsequent SMCR requirements across the limited, core and enhanced regimes.

The SMCR extension will apply on a legal entity basis. This means that firms with complex group structures will need to consider the impact of the SMCR on senior management within each legal entity as well as the impact on any individuals within the wider group who exert significant influence over the management and conduct of UK-regulated activities within the relevant legal entity. This includes individuals working for non-regulated entities. For groups with several legal entities the SMCR could apply in differing ways; for example one entity may be categorised as enhanced whilst others within the same group could be core. Firms can use the FCA's firm type checker tool to determine which category of the regime will apply to them[6].

The proposed requirements reflect the three existing components of SMCR: the Senior Managers Regime (SMR) itself; the Certification Regime; and the Conduct Rules.

Over 47,000 firms will be affected by the extension of the SMCR to FCA solo-regulated firms, including very small firms and those with limited permissions (including sole traders and limited permission consumer credit firms) through to some of the largest global firms. Most firms will be subject to the requirements of the core regime and these requirements should be the starting point for firms. Thereafter, smaller firms will fall into the limited regime (as per our table below) while larger and more complex firms (expected to be c. 350) will be subject to additional requirements under the enhanced regime.

Firm Type	Description
Limited	Firms which are smaller sized are currently subject to a limited application of the Approved Persons Regime such as limited Permission Consumer Credit Firms and sole traders.
Core	The majority of firms will fall under the core scope of the regime and will have a baseline of SMCR requirements applied.
Enhanced	Larger and more complex firms (a smaller proportion of FCA solo-regulated firms) will be subject to additional "enhanced" scope requirements if they meet one of the following criteria stipulated by the FCA: **Definitional criteria** • Significant IFPRU firm; • CASS Large firm; **Criteria calculated on a rolling average** • Assets Under Management of £50 billion or more (at any time in the last three years); • Total intermediary regulated business revenue of £35 million or more per annum; • Annual regulated revenue generated by consumer credit lending of £100 million or more per annum; and/or **Criteria calculated as a point in time** • Mortgage lenders (that are not banks or building societies) with 10,000 or more regulated mortgages outstanding.

6. https://www.fca.org.uk/decision-tree/firm-checker-tool

4. Key requirements of the SMCR

The SMCR can be split into three key pillars and summarised as follows:

Senior Managers Regime

- Introduces new '**Senior Management Functions**' (SMFs) to replace existing Significant Influence Functions (SIF).
- Introduce specific '**Prescribed Responsibilities**' which must be allocated to SMFs.
- SMFs to complete individual '**Statements of Responsibilities**' and have a '**Duty of Responsibility**' under FSMA.
- Firms will need to apply to the FCA for **approval** for individuals to carry out a SMF and must undertake a **criminal record check** as part of this process.

Certification Regime

- Places onus on firms to **certify the fitness and propriety** of key employees carrying out 'certification functions' (previously referred to as 'significant or material harm functions'). This also applies to senior managers.
- Requires **certificates** to be issued to individuals at least annually confirming ongoing fitness and propriety to carry out their role.
- **Replaces regulatory pre-approval** for certain individuals (e.g. CF30s).
- Requires firms to issue **regulatory references** to an individual's new employer if they are taking on a Certification, SMF or notified Non-Executive Director role.

Conduct Rules

- New Conduct Rules to **replace APER principles** and apply to a broader population.
- Tier 1 – Individual Conduct Rules **apply to all employees**, excluding ancillary staff not involved in regulated activities.
- Tier 2 – Senior Manager Conduct Rules **apply to those in SMF positions** and require SMFs to take reasonable steps to control their areas of responsibility.
- **Conduct rule breach reporting** requirements vary depending on the role of the individual in breach.

The following sections set out at a high level the key requirements introduced in each of these three pillars.

Senior Managers Regime

The SMR formalises the regulators' long-standing expectations that Senior Managers should take responsibility for their decisions and the actions of the areas of the firm for which they are responsible. The key components of the SMR are described below.

Senior Management Functions

The SMR replaces the concept of the SIF and Controlled Functions under APR with Senior Management Functions (SMFs). These apply to UK-authorised firms, EEA Branches and Non-EEA Branches, and required SMFs will vary depending on the firm type. Individuals intending to hold an SMF will require regulatory pre-approval.

The SMR introduces a list of 17 SMFs to replace the existing Controlled Functions (see Appendix A) within enhanced firms. Six SMFs will apply to core firms and three SMFs will apply to limited scope firms. The aim is to focus accountability on a narrower number of senior individuals in a firm, with some of the existing functions carried out by more junior individuals (e.g. CF30 customer function) no longer requiring regulatory pre-approval.

As with current SIF roles, individuals intending to perform more than one SMF will require separate approvals for each, but can combine these into a single application.

The FCA has provided guidance to firms on mapping existing APR functions to the new SMFs. Approved Persons at core and limited scope firms will be automatically converted to SMFs wherever possible and firms will not need to apply for re-approval for currently approved individuals where there is no substantive change to the individual's role. Enhanced firms, on the other hand, will need to identify their SMFs and submit applicable conversion or application forms to notify or apply to the FCA for approval.

Statutory Duty of Responsibility and Reasonable Steps

As part of the SMR, the Government introduced a Statutory Duty of Responsibility to be applied consistently to all Senior Managers across the financial services industry.

The Statutory Duty of Responsibility places the onus on Senior Managers to take reasonable steps to prevent regulatory breaches from occurring or continuing to occur, and the Senior Manager Conduct Rules require Senior Managers to take reasonable steps to effectively control their area of the business, to delegate appropriately and to comply with regulatory requirements.

The Statutory Duty of Responsibility supersedes the original 'presumption of responsibility' (which would have reversed the burden of proof), requiring Senior Managers to prove that the steps they took were reasonable. The same tough underlying obligation will remain on the individual to ensure they take reasonable steps, but the burden will be on the regulators to prove that a Senior Manager has failed to do so.

Whilst the term 'reasonable' is generic and relative, the guidance provided by regulators during earlier SMR consultation periods goes some way towards demonstrating what is expected.

"Many people fear that the accountability regime is all about enforcement. We will be upholding the standards through enforcement. But just because something goes wrong in your area of responsibility doesn't mean you are automatically liable. Our approach will be to assess whether you took reasonable, and I mean reasonable, steps to prevent other people breaching the conduct rules".

Jonathan Davidson, Director of Supervision – Retail and Authorisations at the FCA, 20 September 2017

How can I demonstrate that I am taking reasonable steps?

The concept of reasonable steps should already be embedded in Senior Managers' day-to-day actions in managing and controlling their areas of responsibility; it should not fundamentally change how a well-run firm is organised. The challenge posed by the regime is to achieve this in an efficient and consistent way across the firm to reduce the administrative burden on already overloaded businesses and support functions.

Whilst there is no prescriptive list of actions that can be followed to guarantee that a Senior Manager's steps will be viewed as reasonable by a third party after the event, it is possible to adopt a structured approach that will evidence a culture of close and continuous management and improvement.

Taking reasonable steps is not a science, but the following, non-exhaustive, matrix can support Senior Managers to contextualise and evidence how well they run the business and discharge their responsibilities.

Knowledge & Understanding

- **Handover** – on taking on the role ensure you take time to read any handover material and to undertake any additional assessments required to fully understand the key risks and issues facing the business and concerns that the regulator may have highlighted in the past.
- **Know your risks** – work collaboratively with second and third-line functions to understand and manage the risks in your area.
- **Maintain your knowledge** – attend industry forums, seminars and regulatory briefings to ensure that you maintain your technical skills and an understanding of the evolving business and regulatory environment.
- **Capacity and capabilities** – consider whether you have the necessary bandwidth to fulfil your responsibilities and escalate if you have concerns or require additional resource.
- **Market events** – reflect on the broader markets in which the firm operates including external factors (e.g. high profile regulatory issues) that should be considered as part of decision making.
- **Your firm** – request and review regular updates and reports from your team to understand what is going on in your department. Read internal memos and attend relevant forums across the firm to maintain your understanding of the activity of the wider firm and where you fit within it.

Organise & Control

- **Resourcing** – continue to monitor the resourcing requirements of your business area/function including the capacity of individuals. Where there are resource gaps, demonstrate this is understood and is being managed.
- **Succession planning** – put in place a clear structure within your team so that when individuals leave the business their key tasks are not left unassigned.
- **Reporting lines** – if members of your team have dual reporting lines, make clear to them what this means in practice so that they are clear as to whom they are accountable and for what. Where you have a dual reporting line ensure you understand the appropriate escalation channels.
- **Delegations** – where you are delegating key tasks ensure these are clearly assigned/allocated to appropriate individuals. Retain accountability through continuing oversight of the delegated activity (e.g. weekly meetings, daily reports etc.) and where appropriate challenge the information received.
- **Governance** – establish relevant forums to formally discuss issues and help understand the business. Review whether your committee memberships are appropriate and avoid repeatedly sending delegates if you are a committee member.

Review & Improve

- **Reporting** – critically interrogate the information you receive and produce for others. Consider whether this appropriately covers the most material issues. Is this presented in a concise and easily understandable way? Are metrics and key risk indicators aligned to key risks? Ask for the MI you need, not just what is currently available.
- **People** – set relevant objectives for your team and conduct regular performance appraisals to test competence and capability. Identify training requirements for your team and feed into training plans to ensure these areas are covered.
- **Controls** – continually review your control framework and where gaps are identified take steps to improve and update policies, procedures, systems, etc. Work with the firm's support and assurance functions as necessary.
- **Challenge and discussion** – discuss key decisions within your team and welcome challenge. Document outcomes (e.g. email confirmation of decisions taken, actions agreed etc.). Contribute your own opinion to collective decision making and take time to review meeting minutes and actions for completeness and accuracy.
- **Be proactive** – and initially focus attention on the highest priority tasks whilst capturing other actions. Ensure that your team is aware which tasks are critically important at any given point.

Resolve & Learn

- **Take action** – if you become aware of an issue, inaction is not an option. Take steps to resolve and make others aware of the issue, even if it is not directly in your area of responsibility.
- **Support** – recognise your limits and seek and obtain appropriate expert advice or assurance from internal and external sources.
- **Escalate** – escalate and report issues to increase awareness across the firm and to gain support from relevant departments and/or governing bodies.
- **Action plans** – maintain plans with clearly assigned owners and deadlines to enable key projects/work streams to be completed on time. Ensure actions are followed through to completion and are not left unresolved.
- **Lessons learned** – where issues have been resolved ensure that any weaknesses identified are used to inform future audit and testing, for example:
  - consider building case studies into training;
  - perform root cause analysis to assess whether issues are systemic within the wider business; and
  - identify weaknesses in reporting and seek improvements to help prevent similar incidents from occurring in the future.
- **Handover** – where issues remain unresolved ensure that handover documentation provides your successor with a clear overview of the issue.

Prescribed Responsibilities

The FCA has set out a combined list of Prescribed Responsibilities which need to be allocated amongst SMFs (see Appendix B). This will enable regulators to clearly identify which areas of the business Senior Managers are responsible for. Firms that are categorised as limited under the regime will not be required to assign Prescribed Responsibilities.

In general, regulators expect that each Prescribed Responsibility will be allocated to a single SMF. However, it will be possible for responsibility to be wholly allocated to more than one SMF but not split. In these cases, each individual will be deemed wholly responsible for the shared responsibility. Where a Prescribed Responsibility will be shared, the firm must be able to demonstrate that this approach is appropriate and justifiable.

Statements of Responsibilities

Enhanced firms are required to submit Statements of Responsibilities as part of the SMF approval process and resubmit these whenever there is a significant change in the Senior Manager's responsibility. Core and limited scope firms are required to prepare 'Statements of Responsibilities' for their SMFs and must keep these up-to-date, however, they are only required to be submitted to the regulators on request.

The statement records the allocation of responsibilities and ensures that a named individual can be held accountable for each key risk in the business. These individuals will be held to account if something goes wrong in that area.

The FCA published finalised guidance on Statements of Responsibilities and Responsibilities Maps for FCA solo-regulated firms (FG 19/2) in March 2019. The guidance provides examples of completed Statements of Responsibilities sections that firms should use as a reference point. This guidance discusses that a Statement of Responsibilities is not the same as a job profile, and that Statements of Responsibilities should enable someone who is not familiar with how the firm is organised to understand what the individual Senior Manager is accountable for. It also reinforces the importance of retaining past version of Statements of Responsibilities as an important resource for the FCA in supervising the firm.

Additional Requirements for Enhanced Firms

Most solo-regulated firms will be subject to the core regime. The FCA estimates that less than 1% of firms will be subject to the enhanced regime. Those subject to the enhanced regime are likely to be larger in size, have a more complex business structure and higher potential impact on customers. Below are the additional requirements applicable to Enhanced firms.

Overall Responsibility

Enhanced firms are required to ensure there is a Senior Manager with overall responsibility for every activity, business area and management function of the firm. The purpose of this requirement is to prevent unclear allocation of responsibilities and issues going unaddressed.

SYSC 25 Annex 1G provides examples of the business activities and functions of a firm. This list is non-exhaustive. It was originally created at the commencement of the regime for banks, investment firms and building societies and the FCA expects firms to adapt the list of activities to better suit its management arrangements.

> "It is also important that there are clear lines of accountability between a decision made and the senior manager who made it or oversaw it … your statement of responsibility is first and foremost the areas for which you are accountable, not the day-to-day tasks you are responsible for."
>
> **Jonathan Davidson, Director of Supervision – Retail and Authorisations at the FCA, 20 September 2017**

Management Responsibilities Map

The SMR introduces the concept of a Management Responsibilities Map (MRM) to allow regulators to identify who is responsible for every area of a firm.

Enhanced firms will be required to maintain a MRM (for each regulated entity) as a single document setting out, amongst other information: the governance arrangements of the firm; details of the senior management team; reporting lines; and the allocation of responsibilities. The FCA's guidance on statements of responsibilities and responsibilities maps for FCA solo-regulated firms (FG 19/2) provides key questions that it expects firms to consider when completing MRMs.

Enhanced firms will need to ensure the MRM is kept up to date at all times and an SMF will have a Prescribed Responsibility for ensuring the firm complies with the requirements to complete and maintain the MRM.

MRMs and Statements of Responsibilities will be an important supervisory and enforcement tool for regulators. It is clear that when something goes wrong, these will be used by regulators to identify who is responsible for the area of the business where the incident occurred.

Handover Procedures

The SMR requires enhanced firms to establish a formal handover policy, setting out how the firm intends to manage the transition between incoming and outgoing Senior Managers. Individuals assuming new Senior Manager positions should be provided with all the information and materials required to be able to perform their role effectively. Handover documents and certificates should include any instances which have occurred in the past such as unresolved or potential regulatory breaches or any unresolved issues or concerns expressed by the FCA, PRA or other regulatory body.

In preparing a handover certificate the Senior Manager should:

- be a practical and helpful document and not just a record;
- include an assessment of what issues should be prioritised; and
- include judgement and opinion, not just facts and figures.

Non-Executive Directors

- The SMCR applies to a specific population of Non-Executive Directors, including: Chairman; Senior Independent Director; and the Chairs of the Risk, Audit, Remuneration and Nominations Committees.
- Non-Executives captured within the SMCR will be subject to all aspects of the regime, including regulatory pre-approval, Conduct Rules and the statutory duty of responsibility.
- Non-Executives who fall outside the scope of the above will be classed as "Notified Non-Executive Directors". These Non-Executives are no longer required to obtain regulatory pre-approval however these individuals will be subject to criminal records checks and firms will be required to assess their fitness and propriety to undertake the role.

Other Regulatory Requirements

In addition to these key changes the SMR also introduces a number of technical process changes in the FCA and PRA Handbooks. These include:

Conditional and time limited approvals – the regulators may (1) grant an application for approval subject to any conditions that they consider appropriate and (2) grant the application to give approval only for a limited period.

12-week rule – permits an individual to be appointed to provide temporary cover of up to 12 weeks for an SMF manager in situations such as holidays or emergencies and avoids the requirement for precautionary approval. Individuals assuming temporary SMFs will be automatically subject to the Conduct Rules.

> "This government has learnt the lessons of the past. We have reformed Britain's banking regulation to help build a stronger and safer financial system and introduced new rules that mean individuals working in UK firms face some of the toughest sanctions in the world."

George Osborne, Chancellor of the Exchequer, 7 March 2016

Certification Regime

The Certification Regime requires firms to assess the fitness and propriety of individuals within the firm who can potentially put the firm or its customers in 'significant harm'. These individuals must then be issued with a certificate before they are allowed to perform that function. In placing the onus onto firms to certify individuals.

The Certification Regime does not apply to SMFs, as these Senior Managers will have received regulatory pre-approval to perform their functions. The Certification Regime shifts the burden of assessing the fitness and propriety of individuals carrying out high risk roles onto firms and away from the regulators. It requires firms to have regard to qualifications, training, competence and personal characteristics.

"Firms have a special responsibility to ensure that people in positions that significantly affect conduct outcomes can do their job well. We have made it the responsibility of firms to ensure that people who are in significant positions of conduct can do their job well."

Jonathan Davidson, Director of Supervision – Retail and Authorisations at the FCA, 20 September 2017

Certification Functions

The FCA has identified the following certification functions:

- Significant Management (based on current CF29);
- Propriety traders (also covered by current CF29);
- CASS oversight (current CF10a);
- Functions that are subject to qualification requirements (e.g. mortgage advisors, retail investment advisers) (most current CF30s);
- Client dealing (expanded from the current CF30 function to apply to any person dealing with clients, including retail and professional clients and eligible counterparties);
- Algorithmic traders;
- Material risk takers; and
- Anyone who supervises or manages anyone performing one of the functions above.

Annual Certificates

Firms will need to provide all Certified Staff with a certificate confirming that they meet the fitness and propriety requirements of their role prior to undertaking that role. Once a certificate is issued it is valid for a maximum period of 12 months. From our experience of working with banks and insurers to implement the Certification Regime, we observed that many firms co-ordinated annual certification as part of their year-end performance management process. FCA solo-regulated firms should also consider co-ordinating annual certification with the requirement to gain an annual Statement of Professional Standing[7], where relevant.

Certification Prescribed Responsibility

The SMCR requires firms to allocate 'Responsibility for the firm's performance of its obligations under the Certification Regime'. Both core and enhanced firms will be required to allocate this responsibility to an SMF.

The SMF holding this PR should have a particular interest in maintaining oversight of the effective operation of the Certification Regime. This will include ensuring that he/she receives adequate Management Information (MI) to demonstrate that the firm has a robust process in place to support the timely and accurate assessment of individuals' fitness and propriety; to ensure that an individual does not perform a certification function without being certified as fit and proper; and to maintain records of this process and of the certificates issued.

Regulatory References

Firms are currently obliged to issue regulatory references to an individual's new employer if he/she is carrying out a CF30 role. In line with the proposals in the Fair and Effective Markets Review, firms will now be obligated to issue regulatory references to an individual's new employer if he/she is taking on a Certification role or SMF. Reference checks are also required to be obtained for notified Non-Executive Directors.

Regulatory references should provide an overview of the individual's conduct record. Firms will be required to provide the following information to the requesting firm:

- details regarding the candidate's previous role;
- information relating to whether the individual has at any time within the last six years been in breach of Conduct Rules;
- whether the individual has failed to be classed as fit and proper for certification within the last six years; and
- any record of disciplinary action including the basis and outcome.

7. Per FCA Training and Competency Sourcebook.

This information will support firms in assessing the fitness and propriety of new candidates to take on SMFs and Certification roles. However, for the firm providing the reference it will raise a number of legal and operational considerations. Firms should ensure they have appropriate policies and processes in place to determine the appropriateness of information to be included in a regulatory reference.

Financial Services Directory

The FCA published its policy statement PS 19/7[8] on 8 March 2019 which sets out the final rules regarding the Directory, a new public register which firms and consumers can refer to check the details (including status and history) of key individuals working in the financial services sector.

The Directory will operate in parallel to the Financial Services Register (FS Register) which provides a public record of the firms it and the PRA regulate, and the individuals whom they approve. Following the extension of the SMCR, the FS Register contains (or will contain) fewer individuals, as only individuals for specified Senior Manager roles at FSMA-authorised firms will be approved and appear on the FS Register. The public Directory will include information on a wider range of individuals (referred to as Directory Persons) than the FS Register, including:

- all Certified Staff (those holding a certification function under the SMCR);
- directors who are not performing SMFs – both executive and non-executive; and
- other individuals who are sole traders or Appointed Representatives (ARs) (including those within ARs) where they are undertaking business with clients and require a qualification to do so.

The Directory is being introduced to help protect consumers and firms by providing a tool to ensure they only deal with SMFs or those who an authorised firm has assessed as fit and proper, or otherwise suitable (e.g. those who do not perform a certified role but are required to be assessed as suitable) and those who have appropriate qualifications. Additionally, the Directory will support the FCA, law enforcement, professional bodies and other regulators to monitor the market, build intelligence and target interventions.

Firms will need to report certain information about their Directory Persons and will thereafter be responsible for timely and accurate reporting and updating of this information. The required information includes:

- employer details including the firm's name, reference number and contact details;
- restrictions on the firm's activities or permissions;
- the individual's full name and unique reference number;
- the relevant roles held by the individual including certification functions, relevant qualifications, details of non-SMCR Directorships (executive and non-executive), sole traders and/or ARs;
- the start and end date for the aforementioned roles held;
- the types of business the individual is qualified to engage in;
- the geographical location of the individual's workplace(s) (for customer-facing roles requiring qualification);
- customer engagement methods (e.g. online, telephone or face to face) (for customer-facing roles requiring qualification);
- memberships of relevant accredited bodies (for customer-facing roles requiring qualification);
- details of any regulatory sanctions or prohibitions such as a withdrawal of approval or prohibition; and
- the date the information was last updated.

With over eight million views of the existing FS Register last year alone, SMCR firms will need to prepare for more of their data (such as lists of Certified Staff) becoming publically available. SMCR firms are already under an obligation to ensure that their fitness and propriety assessments are sufficiently robust and will need to be mindful that consumers (and firms) will also be relying on this information.

Directory Persons are responsible for providing accurate information to their employer, and the employer is then responsible for carrying out the necessary checks to verify this information and to notify the FCA. Firms will have seven business days to update information on staff joiners, leavers and changes in circumstances, however the FCA encourages firms to report sooner whenever possible. As per SMCR Prescribed Responsibility B, the relevant Senior Manager will be ultimately accountable for the information provided on Directory Persons. Firms will therefore need to have effective and embedded process to capture information on staff joiners, leavers and changes.

The FCA has indicated that banking and insurance firms will be able to submit data on Directory Persons from September 2019, while FCA solo-regulated firms will be able to following the extension of the SMCR in December 2019. Banking firms, insurers and their ARs will have until 9 March 2020 to upload their data to the Directory, while all other firms authorised to provide financial services under FSMA will have until 9 December 2020. The Directory user interface will go live shortly after these deadlines. FCA solo-regulated firms which are preparing to transition to the SMCR should ensure that the requirements for, and implications of the Directory are factored into their implementation plans. Other firms which are already subject to the regime should enact a programme of work to comply with the requirements of the Directory ahead of the submission deadlines and start to gather the required Directory information.

8. https://www.fca.org.uk/publication/policy/ps19-07.pd

Conduct Rules

The SMCR introduces new Conduct Rules to replace the existing Principles for Approved Persons.

The Conduct Rules enshrine the key statutory objectives of the regulators and will provide a framework against which the regulators can assess the actions of individuals across a firm. The Conduct Rules aim to drive up standards of individual behaviour in financial services and shape a firm's culture, standards and policies as a whole.

The main change for firms is that the rules will apply to a much broader population than the rules under the APR. Firms will therefore need to provide training to all employees (except for Ancillary Staff) on the Conduct Rules to ensure that they understand how the rules apply to them in their specific role at the firm. The Conduct Rules are published in the Code of Conduct Sourcebook within the FCA Handbook.

Individual Conduct Rules

The Tier 1 Individual Conduct Rules will apply to all FCA solo-regulated firm SMFs (including Non-Executive Directors and notified Non-Executive Directors) and Certified Staff from 9 December 2019, and will be extended to include all other Conduct Rules Staff (with the exception of 'ancillary staff') from 9 December 2020.

Senior Manager Conduct Rules

In addition to the Individual Conduct Rules, SMFs, Non-Executive Directors and notified Non-Executive Directors must abide by the Senior Manager Conduct Rules. These rules will apply to FCA solo-regulated firms from 9 December 2019.

See Appendix C for a full list of the Conduct Rules.

Reporting breaches of Conduct Rules

Firms subject to SMCR are required to capture, assess, and report breaches of Conduct Rules by individuals who are in scope of the rules.

Where an SMF breaches the Conduct Rules, firms must notify the relevant UK regulator within seven business days.

For conduct rules staff other than SMFs and firms are required to make an annual report notifying the regulators of all disciplinary action taken against individuals resulting from a breach of the Conduct Rules. The report will cover the 12 months between September and the end of August the following year. Where there are no breaches of the Conduct Rules, firms should still declare a 'nil return'.

Firms will also need to adhere to general regulatory obligations to appropriately disclose anything of which the regulators would reasonably expect notice. This may include reporting significant breaches of the Conduct Rules ahead of the annual report.

Conduct Rules Prescribed Responsibility

A significant addition to the original scope of the SMCR was the addition of the Prescribed Responsibility for the 'performance by the firm of its obligations in respect of notifications and training of the Conduct Rules'. Both core and enhanced firms will be required to allocate this responsibility. Firms must allocate this responsibility to a SMF, who must ensure that the firm meets its obligations relating to the Conduct Rules.

> "The conduct rules apply to pretty much everyone. But senior managers have a special role to play, either because they make important decisions, for example on the strategy and business model; or because they oversee the decision making of others. That's not all: they lead the organisation and shape the culture through the tone from the top and the other cultural levers I discussed earlier. It is therefore particularly important that they are fit and proper – that they act with integrity and can act with appropriate skill."

Jonathan Davidson, Director of Supervision – Retail and Authorisations at the FCA, 20 September 2017

5. Lessons learned

Since the SMCR was implemented in 2016, Deloitte has supported over 40 firms with their implementation programmes. This has included banks, building societies, insurers and more recently asset managers and large consumer lending firms. As a result of our work we have developed a number of insights into the challenges for firms transitioning to the SMCR.

In this section we have drawn on our experiences to highlight our top 'Lessons Learned' which we believe are essential for firms to understand as they start their transition programmes.

The principles set out in these lessons are applicable for all firms, recognising that more complex firms will face greater challenges than small firms with simple structures and minimal layers of management. Firms should not underestimate the impact of the changes brought about by the new regimes.

1 Strong and cohesive programme leadership is required

The SMCR requires firms to make changes to a large number of areas across the business and constitutes a major change programme. Without strong leadership the programme can easily get weighed down in technical detail, differences of opinion and resource bottlenecks.

An effective transition programme requires a dedicated and senior project sponsor to lead transition and to engage early on with senior stakeholders. The leaders and sponsors must be able to engage with the Board and Executive to drive decision making that may at times challenge the status quo.

The transition programme should seek to include key stakeholders from across the organisation from the outset. This includes representation from the front office teams in addition to those support functions which will take responsibility for the practical implementation of changes, such as the HR, Compliance, Risk, IT and Legal functions.

Given the substantial change and the complexity surrounding the implementation of the SMCR, firms will need to establish a defined programme management model to break down each stage of the transition into manageable workstreams and to clearly assign owners responsible for seeing through the necessary changes.

2 Allocating responsibilities is not a box-ticking exercise

A key driver behind the introduction of the SMCR is to increase accountability at the top. This is achieved in part by requiring firms to allocate key activities and functions to Senior Managers who have ultimate responsibility for them. Enhanced firms are required to document this in Statements of Responsibilities and a MRM.

Whilst the design of the regulators' Statement of Responsibilities template appears to require little more than ticking the applicable functions and responsibilities for each Senior Manager, the reality behind those 'ticks' is more complicated.

Enhanced firms will need to make sure that every activity, business area and management function has a SMF with overall responsibility for it, including material projects and initiatives. The regulator's aim is to prevent unclear allocation of responsibilities and issues falling between the cracks. Defining and allocating overall and other responsibilities is likely to be an iterative process. There may be significant discussion required around the definition and allocation of these responsibilities.

As SMFs are identified and responsibilities begin to be allocated, firms may find that SMFs will require a great deal of one-to-one engagement with Compliance, Company Secretary and HR functions to ensure they are comfortable with the areas of responsibility assigned to them and that the limits of their accountability are understood. Accordingly, firms should try to engage with potential SMFs early and bring them together as necessary to help identify and resolve any gaps or overlaps in coverage. Firms should be prepared for these discussions to lead SMFs to reflect on whether their current infrastructure and departmental governance arrangements are fit for the new purposes of the SMCR.

The SMCR can have a material impact on the way senior individuals view their roles and responsibilities and as a consequence there are likely to be questions on remuneration. Our experience has shown that it can be beneficial for firms to have a consistent message on reward from the outset and to engage with stakeholders early to prevent these discussions from affecting the transition timelines.

3 Mapping management interactions may lead to structural change

For firms operating within groups, a key challenge of the SMCR has been mapping group responsibilities and interactions in a way that demonstrates the primacy and independence of Senior Managers.

In practice many firms operate under strong direction from their parent company and main shareholders. This does not sit easily under existing regulatory expectations that each regulated firm is responsible for its own actions, and even less so with the expectation of individual accountability under the SMCR. Consequently, some firms may have to re-visit their governance structures.

A key consideration for firms with reporting lines into a group is to determine which individual is ultimately responsible for the activities being carried out in the regulated entity. The individual who takes on the Senior Manager role should be the one with day-to-day control over the activity of the function and for reporting on that function to the Board of Directors.

In complex firms, determining whether it is the local head or the group head who is ultimately responsible at a local level can involve protracted discussions and potential structural change.

In our experience the key changes resulting from these discussions are the clarification of reporting lines (and delegated responsibilities) and ensuring Senior Managers have control over the local implementation of budget, strategy and resourcing decisions. It is important that rationale for allocation of responsibilities is clearly documented and that delegations of Prescribed Responsibilities are formally documented (while the SMFs responsible for the particular Prescribed Responsibilities remain accountable).

4 There is no technology silver bullet

The SMCR may feel like another compliance exercise which can be implemented with the help of software or an SMCR tool; it is not. It requires the programme implementation team to have a deep understanding of the business, to be able to identify where gaps in responsibilities and accountabilities arise.

As with many significant change projects technology can assist in addressing SMCR challenges, however there is no technology solution that "solves" the SMCR. Fundamental processes and structures need to be established at the outset and then technology options considered to help embed these. The majority of banks and insurers have not created or purchased SMCR systems, rather they have looked at existing systems and implemented changes as required. The most common amendments have been to core HR systems to flag Certified roles and embed Certification steps into annual performance reviews. If new systems are being considered by firms, then a rigorous requirement definition should be undertaken and existing systems considered as the primary option.

5 SMCR will drive fundamental changes to employee processes

The SMCR has the potential to be administratively burdensome at a time when many firms are reducing capacity within support functions.

However, the most challenging administrative changes will be driven by the Certification Regime which introduces a number of new requirements which will lead to changes across numerous processes and systems.

Identifying who falls within the Certification Regime population will require adaptations to the recruitment and promotions process to ensure all relevant individuals are certified prior to undertaking the role. Job descriptions and advertisements will need to reflect that a role will require Certification before the interview process begins. Where an individual is promoted into a new role or takes on new responsibilities, managers will also need be trained to identify whether the role requires certification.

Many banks initially focused effort on the Senior Manager implications and considered certification as a secondary priority. This resulted in rushed changes to the processes needed to comply with certification requirements which were not fully embedded by the commencement date.

The process of certifying individuals as fit and proper at induction and annually thereafter will affect the entire HR lifecycle. The on-boarding process should be reviewed to determine whether all relevant background checks are being undertaken prior to an individual taking on a role and to formally capture evidence of the individual's competence during the interview process. The annual appraisal process will also need to be adjusted to ensure it factors in the key tests of fitness and propriety.

6 Successful transition programmes start early and communicate clearly

The impact of the SMCR will be far reaching for firms. In our experience early engagement is vital so as to understand the scope of the changes required and assess the way in which it affects the organisation.

Setting the tone at the top of the organisation can assist in embedding longer-term strategic change to align the requirements of the SMCR. It is important that implementation drives a cultural change which encompasses not only the letter of the regulation itself but the spirit in line with the regulators' expectations. Fostering such an environment can enhance transparency, provide opportunity for greater collaboration and strengthen client centricity. Successful change cannot occur without the engagement and support of the business.

A clear communications plan drawn up at the outset can help to maintain clear dialogue with Senior Managers, the Certification Regime population and the wider firm (including the Board) to ensure greater engagement when implementing process and system changes. Specifically with respect to the Board, it is important that approval milestones are planned out to ensure a smooth approval process. This is especially the case given most firms have few scheduled Board meetings between now and December 2019. In the past we have found that some firms' Directors (including Non-Executive Directors) have wanted more active discussion and an opportunity to input at an earlier stage than planned.

7 Ownership post implementation should be agreed at the earliest stage

Whilst existing APR processes can be updated to manage the approval of SMFs and their Statements of Responsibilities, the ongoing maintenance of the MRM can be more challenging, requiring key governance and reporting line changes to be monitored and regularly updated.

Some firms may choose to establish an 'SMCR Office' to coordinate these requirements and to provide practical support and guidance to Senior Managers.

Whilst the regulatory change programme of work may sit with Compliance or Risk, firms should keep in mind the need for the SMCR to be embedded in BAU. Therefore, early consideration should be given to who in the first line will be responsible for SMCR processes post-implementation.

8 Training for all affected staff needs to be meaningful and manageable

The new Conduct Rules also require firms to introduce new training programmes to ensure staff understand the rules and how they apply to their role.

The Conduct Rules set out expected behaviours for all of those staff covered by the SMCR. They are split into two tiers: Individual Conduct Rules and Senior Manager specific Conduct Rules. Once the relevant population has been determined, firms should make the individuals aware that they are subject to the Conduct Rules. Additionally firms should, according to the SMCR provide appropriate training and be responsible for ensuring compliance with the training requirements.

Firms may want to separate the training into three distinct categories: Senior Managers (including Non-Executive Directors and Notified Non-Executive Directors), Certified Persons and other Conduct Rules covered staff. By doing so, firms are able to tailor training so that individuals are able to determine how the rules apply to them in their role. Completion, or non-completion, will have to be tracked and followed-up centrally. Firms will also need to have policies and systems in place to support the monitoring and reporting of breaches of the Conduct Rules.

6. Implementation activities

Deloitte has worked closely with a range of firms since the proposed SMCR rules were first announced in July 2014 to develop, design and deliver the changes needed to comply. The burden of implementation activities for firms will vary dependent on the complexity and size of the firm. The regulators expect firms to take a proportionate approach, however the actual activities remain largely the same regardless of the size of your firm.

In this section we set out the key implementation activities firms should consider building into their transition programmes and resource plans.

Senior Managers Regime

1. **Determining firm type** – conducting an assessment to determine which category (enhanced, core or limited scope) of the regime applies to each firm (must be completed for each legal entity). Firms can choose to opt-up into another category, however, they will be required to comply with all of the category's relevant rules – they cannot choose to apply ad hoc elements of the selected regime.
2. **Identifying SMFs** – identifying who within the organisation is performing a defined Senior Manager role and establishing whether they meet the conversion requirements for that role, or if they require additional approval from the regulators. This includes identifying whether any individuals at the group/parent level need to be captured.
3. **Allocating responsibilities** – agreeing the distribution of Prescribed Responsibilities and key functions amongst the identified Senior Managers, ensuring no gaps and no splitting of responsibilities. Firms should also consider the regulators' definition of Overall and Other Responsibilities to define and allocate amongst SMFs. The process of allocating responsibilities requires education of, collaboration with, and agreement by the senior management team.
4. **Statements of Responsibilities** – recording the allocation of responsibilities in each of the SMF's Statements of Responsibilities and working with the SMFs to agree the description of their role and wider responsibilities. Each SMF must agree to and sign his/her statement. Enhanced FCA solo-regulated firms are required to submit completed Statements of Responsibilities to the FCA in its prescribed format; core and limited scope FCA solo-regulated firms are not required to submit, however should prepare and have these available on request by the FCA.
5. **Refining role profiles and job descriptions** – revisiting role profiles and job descriptions to ensure they accurately reflect the responsibilities, reporting lines and delegated authorities of Senior Managers and their direct reports following the process of allocating responsibilities which can often lead to changes of existing roles. Clarifying the limits of delegated authorities is particularly important given the Senior Manager Conduct Rule relating to the appropriate management of delegated activities.

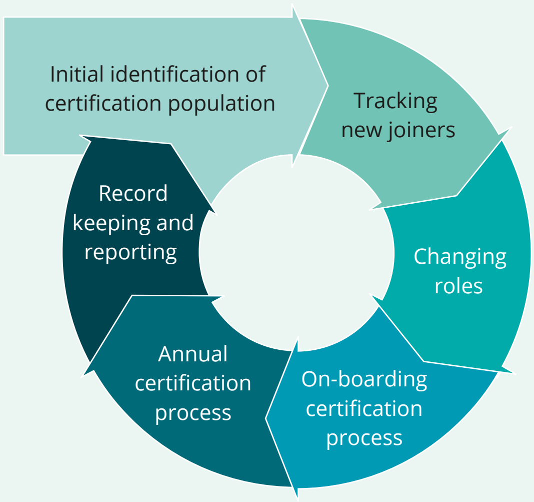
Additional requirements for enhanced firms:

6. **Management Responsibilities Map** – pulling together existing governance and organisational documents into a single overarching map which records the key arrangements, reporting lines and responsibilities of the firm. Whilst the minimum contents of the MRM are set out in detail, there is no prescribed format for firms to follow. Drafting an MRM can help to identify gaps or overlaps in the allocation of responsibility that require resolution. The MRM will be a key document for each firm going forward and should be reviewed and approved at the Board or an appropriately authorised committee.
7. **Developing a 'Handover' policy** – establishing a robust policy to facilitate the process of handover for incoming and outgoing Senior Managers. Polices will also need to take into account situations where Senior Managers depart quickly. A balance needs to be maintained whereby the outgoing Senior Manager is assured all information has been highlighted and documented and the incoming Senior Manager is confident he/she has all the information to carry out the new role. Handover arrangements demonstrate to the regulators that all reasonable steps have been taken to ensure the new Senior Managers are aware of all information and risks or regulatory concerns when taking on the new role and what falls within their remit.

Certification Regime

1. **Identifying the initial certification population** – working with the front office to determine which of the Certification Regime categories are applicable to the organisation and analysing which individuals currently meet those criteria. This may require an in-depth analysis of existing regulatory permissions and the actual scope and nature of the role being undertaken by the individual.
2. **Reviewing the Certification Lifecycle** – undertaking workshops with key stakeholders from HR, Compliance and Legal to identify the current recruitment, on-boarding and performance management processes which could be adapted to support the certification process. The certification process is complex and involves ongoing monitoring of people moving in and out of roles, so it is essential to identify (and close) gaps in the current process and establish new workflows to manage the 'Certification Lifecycle' – see sidebar below.
3. **Issuing certificates** – establishing a process and system for recording the fitness and propriety assessment of Certified Persons. A robust system will enable firms to track when certificates are due for annual renewal, record the rationale behind each certification decision and provide a process for challenge or appeal where an individual fails to meet the fitness and propriety criteria required for a role.
4. **Issuing regulatory references** – ensuring any failures to meet the fitness and propriety requirements for certification roles are recorded, along with relevant breaches of the Conduct Rules, to enable the accurate provision of regulatory references upon request.
5. **Preparing and maintaining Directory and FS Register data** – obtaining and submitting the required information about the firm's Directory Persons, and thereafter maintaining this information in a timely manner. Firms will have seven business days to update information on staff joiners, leavers and changes in circumstances, however the FCA encourages firms to report sooner whenever possible.

The Certification Regime within the Employee Lifecycle



The Certification Regime introduces considerable administrative and process challenges for firms to ensure they remain compliant with the requirements. The larger and more complex the firm, the greater the potential burden. We have set out below the key elements of the 'Certification Lifecycle' which should be considered when establishing a certification process.

Tracking new joiners – ensuring individuals do not start a certification role without being identified as such. Identification of roles requiring certification needs to be built into recruitment processes and existing systems.

Changing roles – tracking promotions into Certified roles and identifying when someone takes on new responsibilities which meets the threshold of a certified role.

On-boarding certification process – adapting current recruitment processes to meet the fitness and propriety requirements including background checks (e.g. criminal, qualifications, referencing etc.); and assessing competency during the interview process.

Annual certification process – introducing processes to enable the tracking and recording of multiple certification assessments, bringing together competency assessments, breaches of Conduct Rules and ongoing assessment of honesty, integrity and financial soundness.

Record keeping and reporting – recording each step of the process to enable reporting to the appropriate Senior Manager demonstrating whether the process is working effectively.

Conduct rules

1. **Senior Manager, Non-Executive Director and notified Non-Executive Director training** – providing tailored one-to-one or classroom training on the new Conduct Rules. FCA solo-regulated firms will be required to have fully trained Senior Managers and notified Non-Executive Directors by 9 December 2019. From our previous experience, the most effective way to ensure they are entirely informed of their responsibilities is through individually designed sessions which make use of relevant case studies and scenarios to delve deeper into the rules, the practical application to their roles and the expectations of regulators.

2. **Certified Persons and other Conduct Rules staff training** – developing or procuring computer based Conduct Rules training for those firms with hundreds or thousands of Certified Persons and Conduct Rules staff, where providing bespoke training is not always achievable. Such training can be the most efficient way to deliver and track training across a wide population. However, it is important that firms ensure the training remains tailored to their specific organisation and the roles of their people.

3. **Conduct Rules breaches** – defining Conduct Rules breaches and introducing process for monitoring and reporting breaches. There is no definitive guidance stating what constitutes a breach of the Conduct Rules, so each firm must make its own determination of what activities they would consider a breach of the rules and this needs to be clearly communicated to staff. Firms also need to be able to monitor compliance with the Conduct Rules and to report any breaches resulting in disciplinary action to the regulators.

Testing embeddeness

1. **Internal audit reviews** – firms should plan ahead by building SMCR into the Audit plan ahead of the commencement date. Undertaking an independent review of the transition programme will enable the identification of any gaps or weaknesses ahead of commencement. Post commencement, internal audit reviews can continue to be used to test embeddedness and to focus on areas of perceived weaknesses. Such reviews could form part of demonstrating that the Senior Manager responsible for SMCR is taking reasonable steps to ensure the firm remains compliant.

2. **External embeddedness testing** – utilising external consultants and legal counsel to test embeddedness post implementation can help to establish whether all the elements of the new regime have been complied with, identify any gaps requiring remediation and test new systems and controls to see if they work in practice. Such testing can focus on high-risk areas, or areas of concern for individual Senior Managers.

3. **Reasonable steps gap analysis or health check** – Senior Managers will be taking on greater accountability under the SMCR and may benefit from a review of their area or areas of responsibility. In particular, undertaking a gap analysis of current systems, controls and governance arrangements and recommending improvements to enable them to control their areas more effectively and demonstrate they have taken reasonable steps.

7. Summary

The SMCR brings a shift in the emphasis of accountability throughout the financial services sector. It seeks to empower organisations and the individuals within them to be clear and transparent about their responsibilities.

The SMCR should not fundamentally change how well-run firms organise their business, however it imposes significant operational requirements on firms, both in implementation and as on-going business-as-usual activities. By focussing on these key areas sooner rather than later, the transition to the SMCR can be significantly smoother. Early planning, allocating sufficient project resources and drawing on appropriate specialist support will ensure your firm is in the best position to comply with the new regime.

Our extensive experience with clients in the banking and insurance industries allows us to understand the pitfalls that have impacted other firms and to look back at best practice for implementing the proposed changes across the wider financial services industry. Those firms that treated implementation of SMCR as a box-ticking exercise missed the point and found embedding the regime consistently across the organisation to be a greater challenge than expected. The firms who were most successful in implementing SMCR were those that planned carefully; reinforced clear individual accountability and robust governance without introducing unsustainable bureaucracy; and communicated the impact of the regime effectively to Boards, Senior Managers and staff.

The FCA presented proposals regarding changes to the regime in CP 19/4 'Optimising the Senior Managers & Certification Regime and feedback to DP16/4 – Overall responsibility and the legal function'. Submissions closed on 23 April 2019 and the regulators have indicated that a policy statement will be released in Q3 2019. The FCA's proposals include: clarifying the application of the SMCR to the Legal Function; amending the intermediary revenue criteria for the Enhanced tier; amending the scope of the Client Dealing Function; including the Systems and & Controls Function in the Certification Regime; applying Senior Manager Conduct Rule 4 to non-approved executive directors at Limited Scope firms; and other minor changes to the FCA's regulatory forms and Handbook. Firms should take the time to consider the elements of the proposed changes and factor these into their implementation programmes, ensuring that they understand the potential implications for their firm.

8. How we can help

Deloitte has a strong track record of successfully designing, implementing and review the SMCR, having worked with over 40 firms on various programmes. Key areas in which we can support include:

Defining reporting lines and apportioning responsibilities

- Creating formal and robust documentation of your firm's governance arrangements in the form of Responsibilities Maps and Statements of Responsibilities
- Mapping existing Controlled Function holders onto the new SMF framework and supporting identification of your certification population
- Apportionment amongst Senior Managers of the proposed FCA responsibilities. Ensuring all required responsibilities are allocated to one or more appropriate individual

Designing appropriate and effective MI

- Developing accurate and insightful MI across all risk types against well-defined and articulated risk appetite tolerances
- Utilising existing information from across the business to produce a consolidated view of conduct risks within the organisation against risk thresholds
- Introducing delineated MI on a legal entity basis as well as by business line

Designing and facilitating training, embedding culture and monitoring individual behaviours

- Formalising Board and senior management training to include preparation for the new framework
- Updating training ahead of regulatory approvals to ensure individuals undergoing the new Senior Manager approval process are fully aware of their responsibilities under the new regime
- Deployment of training on the regime and the conduct rules to SMFs and Certified Staff
- Embedding a culture of accountability through training, improved documentation, communication and involvement from Senior Managers
- Implementing effective conduct breach monitoring

Programme co-ordination and support

- Programme planning, lead and co-ordination support, and/or workstream management
- Development of policies and processes, including, for example: reasonable steps frameworks, handover policy, overarching SMCR policy, fitness and propriety policy, conduct rule breach identification and reporting process
- Drafting of regulatory required documents including Statements of Responsibilities and Management Responsibilities Maps

Post implementation reviews

- Provision of internal audit support, by way of providing SME support to a firm's internal audit team, or through deployment of a team to conduct an internal audit on behalf of the firm
- Performance of SMCR health check to examine Senior Managers' approach to taking and evidencing reasonable steps

Appendices

A. Senior Management Functions

SMF	Function	Firm Type				
		Limited	Core	Enhanced	Non – EEA branches	EEA branches
SMF1	Chief Executive function	–	X	X	–	–
SMF2	Chief Finance function	–	–	X	–	–
SMF3	Executive Director function	–	X	X	X	–
SMF4	Chief Risk function	–	–	X	–	–
SMF5	Head of Internal Audit function	–	–	X	–	–
SMF6	N/A	–	–	–	–	–
SMF7	Group Entity Senior Manager function	–	–	X	–	–
SMF8	N/A	–	–	–	–	–
SMF9	Chairman function	–	X	X	–	–
SMF10	Chair of the Risk Committee	–	–	X	–	–
SMF11	Chair of the Audit Committee	–	–	X	–	–
SMF12	Chair of the Remuneration Committee	–	–	X	–	–
SMF13	Chair of the Nomination Committee	–	–	X	–	–
SMF14	Senior Independent Director	–	–	X	–	–
SMF15	N/A	–	–	–	–	–
SMF16	Compliance Oversight function	X	X	X	X	
SMF17	Money Laundering Reporting function	X	X	X	X	X
SMF18	Other Overall Responsibility function	–	–	X	–	–
SMF19	Head of Third Country Branch	–	–	–	X	–
SMF20	N/A	–	–	–	–	–
SMF21	EEA Branch Senior Manager	–	–	–	–	X
SMF22	N/A	–	–	–	–	–
SMF23	N/A	–	–	–	–	–
SMF24	Chief Operations function	–	–	X	–	–
SMF25	N/A	–	–	–	–	–
SMF26	N/A	–	–	–	–	–
SMF27	Partner	–	X	X	X	–
SMF28	N/A	–	–	–	–	–
SMF29	Limited Scope function	X	–	–	–	–

Note: The regulators do not propose to utilise Senior Manager Functions marked as "N/A" in the extension of the SMCR to FCA solo-regulated firms.

B. Prescribed Responsibilities

Prescribed Responsibility*	Description
Prescribed Responsibilities applicable to both core and enhanced firms	
A	Performance by the firm of its obligations under the Senior Managers Regime including implementation and oversight
B	Performance by the firm of its obligations under the Certification Regime
B-1	Performance by the firm of its obligations in respect of notifications and training of the Conduct Rules
D	Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime
Z	Responsibility for the firm's compliance with CASS (if applicable)
ZA	Responsibility for an Authorised Fund Manager (AFM) value for money assessments, independent director representation and acting in investors' best interests[9]
Prescribed Responsibilities applicable to enhanced firms only	
C	Compliance with the rules relating to the firm's Responsibilities Map
J	Safeguarding and overseeing the independence and performance of the internal audit function (in accordance with SYSC 6.2)
K	Safeguarding and overseeing the independence and performance of the compliance function (in accordance with SYSC 6.1)
L	Safeguarding and overseeing the independence and performance of the risk function (in accordance with SYSC 7.1.21R and SYSC 7.1.22R)
J-3	If the firm outsources its internal audit function, taking reasonable steps to ensure that every person involved in the performance of the services is independent from the persons who perform external audit, including: • Supervision and management of the work of outsourced internal auditors; and • Management of potential conflicts of interest between the provision of external audit and internal audit services
T	Developing and maintaining the firm's business model
S	Managing the firm's internal stress-tests and ensuring the accuracy and timeliness of information provided to the FCA for the purposes of stress-testing

*Prescribed Responsibility reference per FCA Statement of Responsibilities for solo-regulated firms template, contained in PS 18/4.

9. In line with SYSC 24.3.3 G, this Prescribed Responsibility only applies to AFMs and, where the firm has an individual approved in the SMF9 Chair function, the Prescribed Responsibility should be allocated to this individual. Where an AFM does not have an SMF9 Chair, they must assign the Prescribed Responsibility to another appropriate Senior Manager.

C. Conduct Rules

First Tier – Individual Conduct Rules	
1	You must act with integrity
2	You must act with due care, skill and diligence
3	You must be open and cooperative with the FCA, the PRA and other regulators
4	You must pay due regard to the interests of customers and threat them fairly*
5	You must observe proper standards of market conduct*
Second Tier – Senior Manager Conduct Rules	
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

* applied by the FCA only

D. Glossary of Terms

Term	Description	Who does it apply to?
Ancillary Staff	Employees who are not covered by the Conduct Rules, such as cleaners, receptionists, catering staff and security staff.	All firms
Certification Function	A function performed by employees who are not Senior Managers but who could pose a risk of 'significant harm' to the firm or its customers.	All firms
Certification Regime	The part of the regime that covers Certification Functions.	All firms
Criminal Records Checks	A requirement on firms to conduct criminal records checks for Senior Managers and Non-Executive Directors (where a fitness requirement applies) as part of checking that they are fit and proper.	All firms
Directory	The record of Directory Persons which the FCA is required to maintain and will make available for public inspection. The Directory will act as a public register, allowing consumers and firms to check the status and history of key people working in the financial services sector (referred to as Directory Persons).	All firms
Directory Person	An individual who is: an appointed representative Directory person; a Certification employee; a non-SMF director Directory person; or a sole trader Directory person.	All firms
Duty of Responsibility	Every Senior Manager will have a duty of responsibility as a result of FSMA. This means that if a firm breaks one of the requirements, the Senior Manager responsible for that area could be held accountable if they did not take 'reasonable steps' to prevent or stop the breach.	All firms
Fit and Proper Requirements	Firms must make sure all Senior Managers and people performing Certification Functions (i.e. people under the Certification Regime) are fit and proper to perform their role. This must be done on appointment and at least once a year.	All firms
Handover Procedures	A firm must make sure a new Senior Manager has all the information and materials they need to do their job.	Enhanced firms only
Individual Conduct Rules	These are basic standards of behaviour that people performing financial services activities in firms are expected to meet. Firms need to train their staff on the conduct rules and how they apply to them. Firms will need to report breaches of Conduct Rules resulting in disciplinary action every year.	All firms
Other Overall Responsibility Function	A Senior Management Function that applies where a senior executive is the most senior person responsible for an area of the firm's business but they do not perform any other Senior Management Function.	Enhanced firms only
Overall Responsibility	A requirement for every area, activity and management function of the firm to have a Senior Manager with overall responsibility for it.	Enhanced firms only
Prescribed Responsibilities	FCA-defined responsibilities that must be allocated to an appropriate Senior Manager.	All firms except limited scope firms
Regulatory References	Information that firms need to share with each other when an employee or director moves from one firm to another (for candidates of Senior Managers Functions, Non- Executive Directors and Certification Functions).	All firms

Term	Description	Who does it apply to?
Responsibilities Maps	A document setting out a firm's governance and management arrangements, and how responsibilities are allocated to individuals within the firm.	Enhanced firms only
Senior Management Functions	Roles requiring regulatory pre-approval from the FCA.	All firms
Senior Manager Conduct Rules	These are additional Conduct Rules that apply to all Senior Managers. Firms need to train Senior Managers so they understand what the Conduct Rules are and how they apply to them. Firms will need to report breaches of all Senior Manager Conduct Rules by Senior Managers resulting in disciplinary to the FCA within 7 days.	All firms
Senior Managers	The people who perform a Senior Management Function. These people need FCA approval before they start carrying out their jobs.	All firms
Senior Managers Regime	The part of the regime for Senior Managers. The key components of the regime include Senior Management Functions, Statement of Responsibilities, Regulatory References and criminal records checks. For enhanced Firms, the Regime also includes Responsibilities Maps, Handover Procedures and consideration of Overall Responsibility across the firm.	All firms
Statement of Responsibilities	A document that every Senior Manager needs to have that sets out what they are responsible and accountable for. This needs to be submitted to the FCA when a Senior Manager is being approved and be kept up to date to reflect each SMF's responsibilities.	All firms

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