

Financial Regulatory Alert

July 28, 2017

Financial Conduct Authority Consults on Senior Managers and Certification Regime

On 26 July 2017, the UK Financial Conduct Authority (FCA) published its much-anticipated Consultation Paper (CP 17/25) "Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms." The consultation paper sets out the proposed rules implementing the extension of the Senior Managers and Certification Regime (SMCR) to all FCA-authorized non-banking firms in 2018. Feedback on the Consultation Paper is due 3 November 2017, and final rules are expected to be published in 2018.

The FCA proposes a tiered model of application for the extended SMCR. Most firms will fall within the "core regime," however, a small number of firms categorised as "enhanced regime" firms will be subject to additional requirements.¹

The proposed new rules require firms to obtain prior FCA approval for individuals who will be Senior Managers. Senior Managers may be personally liable for breaches of FCA requirements that took place within their area of responsibility. In addition, firms will be required to certify the fitness and propriety of individuals who are not Senior Managers, but who may cause significant harm to the firm or to its customers due to the nature of their role. A new set of Conduct Rules will apply to virtually all individuals within a firm. There is likely to be a form of grandfathering for individuals who are currently Approved Persons who will transition into Senior Managers. The FCA will separately consult on this.

To Whom Does This Apply?

The SMCR will apply to all UK non-bank firms authorised by the FCA. This will include UK group entities of non-UK firms, including US and Asian investment managers with a UK subadviser or a UK execution-only presence. The rules will also affect some non-UK staff of UK firms, including directors or material risk takers based outside the UK.

The core regime

The "core regime" consists of three main elements: Senior Managers Regime; Certification Regime; and Conduct Rules.

1. Senior Managers Regime

An FCA-authorized firm will need to obtain prior approval by the FCA for the most senior staff members whose roles include the performance of "Senior Management Functions." Such approval may be granted for a limited time period, or subject to conditions. The Senior Management Functions include the Chairman function (SMF9), the Chief Executive function (SMF1), the Executive Director function (SMF3) and the Compliance Oversight function (SMF16).

Statement of Responsibilities

Firms must prepare a Statement of Responsibilities (SoR) with respect to each Senior Manager. Firms will need to provide the SoR to the FCA when a Senior Manager applies to be approved and when there is a significant change to his or her responsibilities. If a Senior Manager holds more than one Senior Management Function, he or she will only be required to have a single SoR describing all his or her responsibilities. The FCA will consult separately on the template for SoRs and the submission process in respect of the same.

Duty of Responsibility

Senior Managers will be subject to a duty of responsibility. This means that, if a firm is in breach of its obligations under the FCA's rules or principles, the Senior Manager for the area in which the breach took place could be held accountable. The FCA would have to show that the Senior Manager did not take the steps that a person in his position could reasonably be expected to take to avoid the breach occurring.

Prescribed Responsibilities

The FCA proposes seven "Prescribed Responsibilities" for core firms. Firms will be required to assign each of the Prescribed Responsibilities to a Senior Manager. The Prescribed Responsibilities include the performance by the firm of its obligations under the Senior Managers Regime, including implementation and oversight, the performance by the firm of its obligations under the Certification Regime, the performance by the firm of its obligations in respect of notifications and training of the Conduct Rules and the responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime.

2. Certification Regime

The Certification Regime will apply to employees who are not Senior Managers, but whose role means that it is possible for them to cause significant harm to the firm or its customers. These are called "Certification Functions." The FCA proposes to apply the Certification Regime only to employees of a firm. "Employees", for these purposes, is broadly constructed. The Certification Functions include the significant management function; the client dealing function, algorithmic trading, proprietary traders and material risk takers.

The FCA will not approve certified staff, but firms will need to assess and certify the fitness and propriety of the certified staff to perform their roles. The certification should take place at least annually. The Certification Regime will apply to employees who are based in the UK or who are based abroad, but who have contact with UK clients. However, staff in the category of material risk takers will fall within the scope of the Certification Regime regardless of where they are located.

3. Conduct Rules

The Conduct Rules are enforceable by the FCA against individuals. The individual Conduct Rules will apply to all staff, except certain ancillary staff such as receptionists, cleaners and catering staff. The FCA proposes to apply the Conduct Rules to a firm's regulated and unregulated financial services activities; this is a narrower scope than for the banks, for which all activities are within the scope of the Conduct

Rules. The Conduct Rules are divided into two tiers, the first tier being applicable to all staff, and the second tier being applicable to Senior Managers only. The Conduct Rules are high-level guidance and largely replicate the principles currently applicable to Approved Persons. They are informed by the Principles for Businesses.

4. The Enhanced Regime

The largest and most complex firms will be subject to certain additional requirements under the enhanced regime. Enhanced regime firms will include “significant investment (IFPRU) firms” and firms with AUM of £50 billion or more.

Enhanced firms will need to comply with the core regime requirements and certain additional requirements. These additional requirements include additional Senior Management Functions and additional Prescribed Responsibilities, as well as an overall responsibility for every business activity and management function of the firm. In addition, an enhanced regime firm will have to compile a responsibilities map that sets out the firm’s management and governance arrangements.

5. Regulatory References

The FCA proposes to require firms to request a reference from the past employers of an individual who is a prospective Senior Manager or Certification Regime employee for the preceding six years. The rules on regulatory references will require firms to share information with other FCA-authorized firms in a standard template, including details of any disciplinary action taken due to breaches of the Conduct Rules. Firms will also be required to update regulatory references if new and significant information concerning a previous employee comes to light.

6. Non-Executive Directors

Where a firm has a Chairman, this individual will be a Senior Manager (SMF9). However, the proportional implementation of the SMCR means that no other Non-Executive Director (NED) is required to be approved as a Senior Manager. Under the FCA’s proposal, NEDs will be subject to all of the individual Conduct Rules, as well as SC4 (the requirement to disclose appropriately any information of which the regulator would reasonably expect notice). In addition, firms will be required to comply with the requirements for regulatory references, fitness and propriety, and criminal records checks.

Next Steps

Firms will need to consider their internal staff records, and their management and oversight structures, in order to prepare for the implementation of the SMCR. If you have any questions about the matters addressed in this alert, please contact the following Akin Gump authors or your regular contact at Akin Gump.

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ⁱ “Limited scope firms” will be subject to a reduced set of requirements. This alert does not discuss the requirements applicable to “limited scope” firms.