

THE SENIOR
MANAGERS
AND
CERTIFICATION
REGIME

SM&CR

FOR SOLO FIRMS
UNWRAPPED

A PRACTICAL GUIDE
FOR THE C-SUITE



“

Just before the new accountability regime was introduced, I was at an event debating the concept of responsibility; with many arguing it was hard to define. A young lady stood up and said she didn't understand what all the fuss was about. She was teaching her children to take responsibility for their actions - so why would people who work in financial services be any different?

”

Andrew Bailey FCA CE September 2016

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EXECUTIVE SUMMARY

This paper aims to provide an overview of the Senior Managers and Certification Regime (SM&CR) for Senior Executives and detail the salient points of strategy for Retail Investment Adviser (RIA) firm owners and their teams to implement, so as to ensure clear understanding, a smooth transition and promote high accountability. This paper will cover the following key areas:

Key SM&CR Areas and Strategies

The three tiers of firm regimes: These are Enhanced, Core and Limited firms.

The SM&CR elements: As Table 1 illustrates, firms must know which of the regime elements apply to them and implement accordingly.

The Senior Managers Regime: This will require firms to define roles for relevant individuals, ensuring that they have the right skills and knowledge, and hold the appropriate responsibilities, and that these are clearly documented and understood.

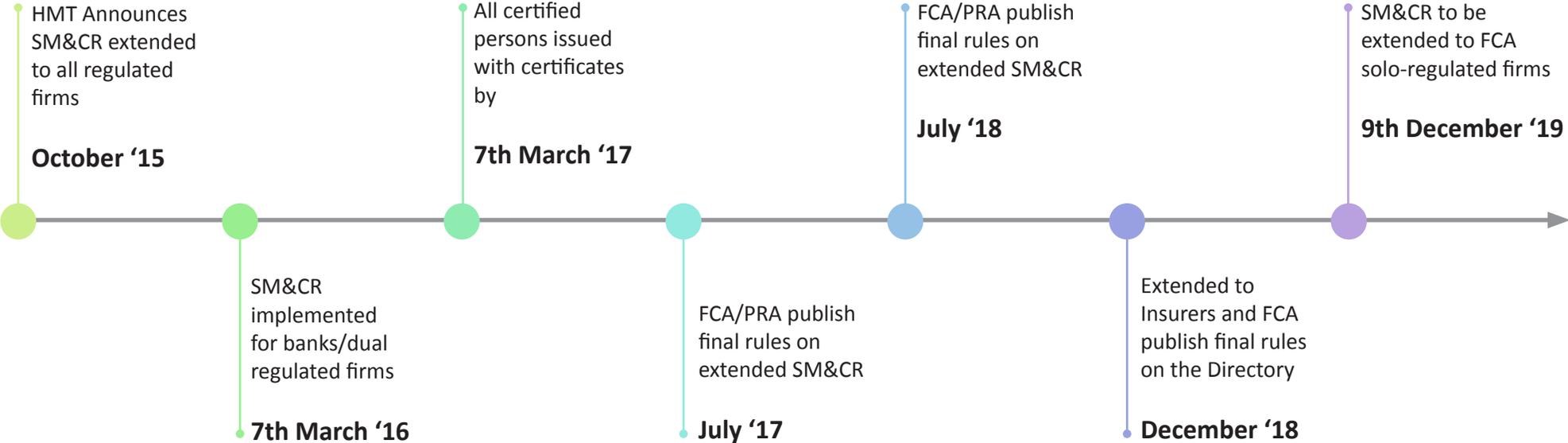
The Certification Regime: This will require firms to annually assess and review the fitness and propriety of key staff members. The SM&CR's philosophy is to target a smaller number of Senior Managers than the **Approved Persons Regime (APER)**, and firms then certify that these managers are suitable to perform their role.

The Conduct Rules: Firms will need to know the difference between the two tiers of Conduct Rules and how they apply to individuals within the firm. Firms should also understand that these rules are a significant extension of scope compared with the **APER**.

Table 1. How SM&CR Elements apply across the three regimes

| SM&CR Elements | Enhanced | Core | Limited |
|--------------------------------|----------|------|---------|
| Responsibility Maps | ✓ | | |
| Handover procedures | ✓ | | |
| Senior Managers (SM) Regime | ✓ | ✓ | ✓ |
| SM Conduct Rules | ✓ | ✓ | ✓ |
| Senior Management Functions | ✓ | ✓ | ✓ |
| Statements of Responsibilities | ✓ | ✓ | ✓ |
| Duty of Responsibility | ✓ | ✓ | ✓ |
| Prescribed Responsibility | ✓ | ✓ | |
| Criminal record checks | ✓ | ✓ | ✓ |
| Certification Regime | ✓ | ✓ | ✓ |
| Certification Functions | ✓ | ✓ | ✓ |
| Fit and proper requirements | ✓ | ✓ | ✓ |
| Regulatory references | ✓ | ✓ | ✓ |
| Individual Conduct Rules | ✓ | ✓ | ✓ |
| Ancillary staff | ✓ | ✓ | ✓ |

Figure 1: The Timeline To The SM&CR



INTRODUCTION

What is the SM&CR?

The SM&CR is the most personally impactful piece of regulation to hit the financial services industry in decades. Think of the regime as a cultural review of the standards of accountability for each relevant staff member within the firm. Put simply the SM&CR is about ensuring that each firm has the right people in the right roles with the right skills. At Model Office-`MO®, we recognise that the SM&CR is a cultural shift with the new Financial Conduct Authority (FCA) Accountability Regime, and therefore a checklist or tick-box approach cannot be justified. Firms need to apply a holistic framework to all of their business activities, one that sets minimum standards for conduct and behaviour for key staff members.

This guide is designed to provide practical strategies, tasks and ideas that you can ‘plug and play’ within your firm immediately, so you keep your momentum going and ensure you will be 100% compliant by the current deadline of 10 December 2019.

Key SM&CR Questions

Who does the SM&CR affect?

Nearly 50,000 Firm’s will be affected with each firm’s Senior Managers and staff who can cause significant harm within those firms. The SM&CR was initially introduced to deposit takers (banks) in 2016 by the Prudential Regulation Authority (PRA) and recently extended to insurers as of 9 December 2018. With solo firms now included come December 2019, that’s pretty much everyone working within retail financial services.

How Does the SM&CR Classify Firms?

There are three tiers to the regime: Limited Scope Firm, Core Firm and Enhanced Firm (see Table 2).

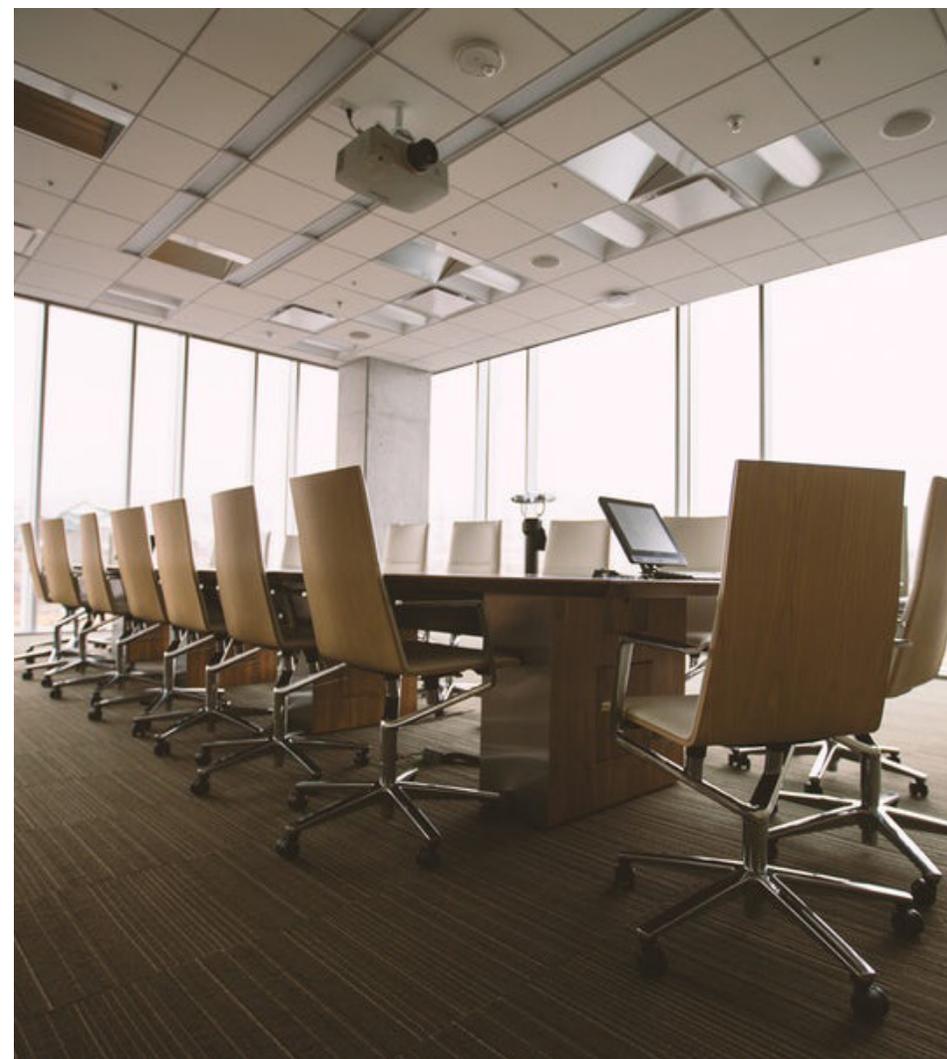
How do firms measure SM&CR compliance success?

Firms are required to step up and effectively show they can self regulate to ensure:

- The most senior people know what they are responsible for
- There is a focus on skills, capability and conduct within the firm – and a commitment to ensuring staff are fit and proper to carry out their roles
- The Conduct Rules set a foundation for how individuals behave
- There is a sense of accountability throughout the firm – individuals speak out when they see harm or potential harm
- Improved systems and controls mean that The FCA can easily assess the suitability of senior management
- The FCA is able to hold individuals to account

Table 2. Firm categorisation

| Firm Type | Firm Numbers | Description |
|--------------------|--------------|--|
| Limited Scope Firm | 33,000 | Sole trader, limited permission consumer credit firm, insurance intermediaries whose principal business is not insurance intermediation, internally managed alternative investment funds, authorised professionals with non-mainstream-regulated activities, service companies, oil/energy market participants, subsidiaries of local authorities. |
| Core Firm | 14,000 | The 'inbetweeners', which have a smaller number of mandated Senior Management Functions (SMFs), many of which transition to Enhanced Firm dependent on the thresholds given below, thus they hold the full remit of aspects of this regime. |
| Enhanced Firm | 350 | Firms with assets under management of £50bn, annual revenue of £30m, consumer lending of £100m, non-bank mortgage lenders with >10,000 outstanding regulated mortgages, large CASS (Client Assets Sourcebook) firms, significant IFPRU (Prudential Sourcebook for Investment Firms) firms. |



What Do Firms Need to Do?

To ensure a smooth implementation and transition there are five key areas you will need to consider and implement: your focus, your engagement, your promise, your systems and your people.

Your Focus

A **project team** will be required to devise and implement a strategic plan, which covers:

- Your scope and objectives
- Who will lead the plan
- Creating work streams and timelines
- Team involvement across the business
- Including key stakeholders such as the HR Department and Compliance team
- Adapting governance and processes
- Agreeing financial budgets
- Identifying and allocating internal resources
- Identifying and employing external resources e.g. consultancy and technology

Your Engagement

A **review of internal and external communications**, which covers:

- Research and due diligence
- Governance processes across organisational charts, reporting lines, roles and responsibilities
- Strategic and commercial decision-making processes
- Staff who are classed as 'Information Givers' under MiFID II

Your Promise

Creating a constructive conduct culture is crucial. This requires:

- A holistic approach, moving away from tick-boxes to build a balanced scorecard across business behaviour to comply with the 'spirit' of the regime
- Knowing and applying the levels for cultural growth
- Ensuring risk management by:
- Identifying risks early
- Knowing who is responsible for managing risk
- Putting in place mechanisms to improve risk
- Board strategic oversight
- Assessing activities that could undermine conduct

Your System

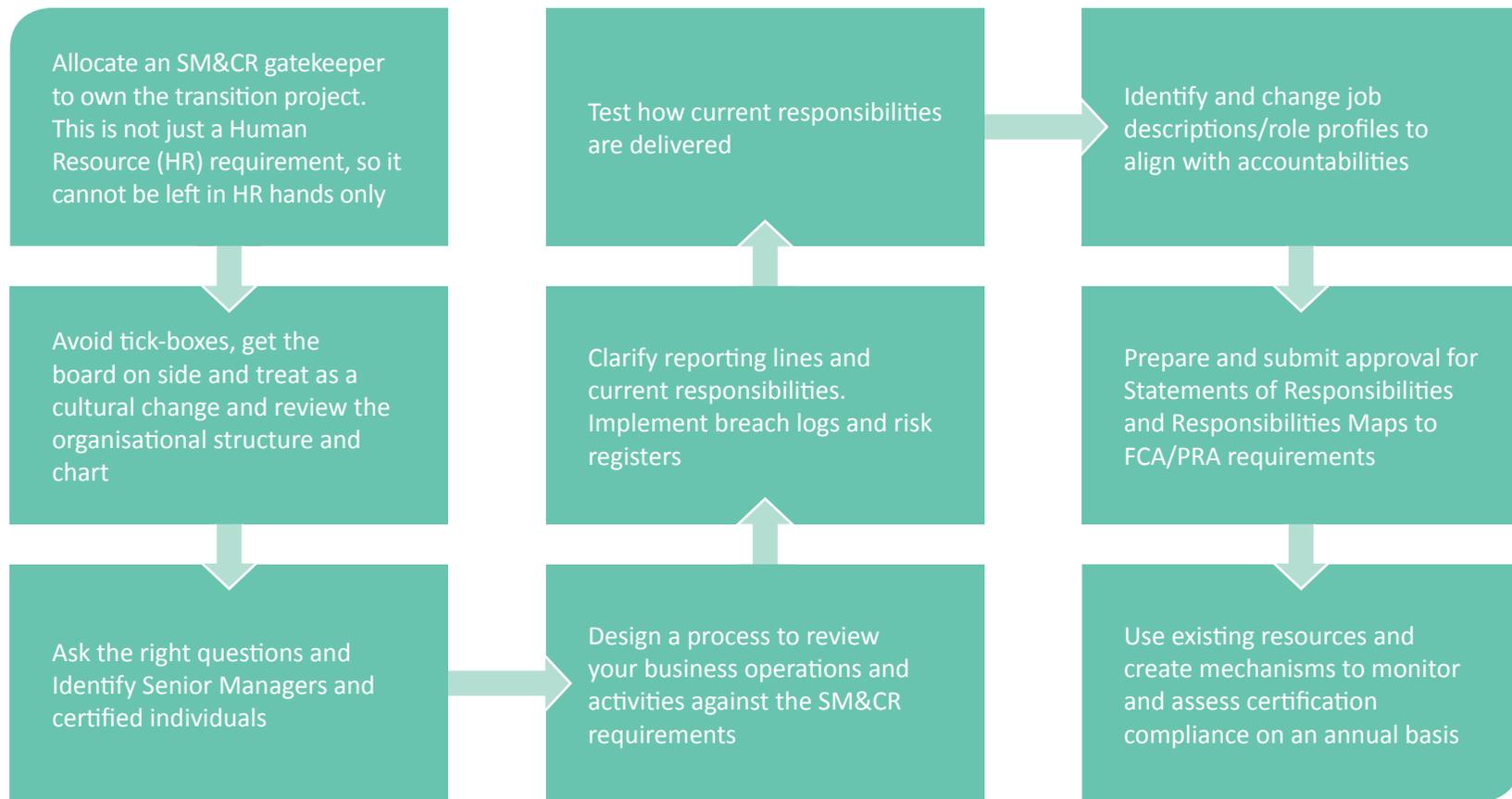
A consistent approach across all business systems and controls is required. This means Senior Management functions (SMFs) should:

- Align Risk and Control Functions with the project team and plan
- Take pre-emptive actions to prevent breaches including reviewing responsibilities and tasks
- Update areas of responsibilities
- Update and monitor policies and procedures
- Agree workflows across relevant administrative activity and tasks
- Agree strict rules for delegation of responsibility
- Gather and monitor management information (MI)
- Implement breach recording and reporting procedures
- Develop a system for challenge and raising issues with staff, committees
- Develop a process for seeking external or internal advice
- Put in place a system to monitor and assess performance against the regime

Your People

- **Staff professional development plans** require focus on:
 - Identifying Senior Managers
 - Allocating Prescribed Responsibilities
 - Drafting and allocating Statements of Responsibilities
 - Defining Duty of Responsibilities and Overall Responsibility
 - Recruitment and contracting that requires clear job descriptions and appropriate timeframes to allow for reference checks
 - Tracking and recording training and competence development with continuous professional development (CPD), and fit and proper requirements
 - Personal development, including coaching and mentoring

Figure 2. How to design and implement a transition and implementation project with key tasks (not a checklist)



When should firms start working on the SM&CR? - Now!

COMPLYING WITH THE SM&CR AND CONSTRUCTIVE CONDUCT AND CULTURE

Culture can be classed as the glue that holds an organisation together and thus can be an enabler or hindrance for performance. Culture is also difficult to measure due to models representing a simplification of reality and its subjective nature. Therefore, we need to present an unbiased model and use diagnostics that provide good validity.

Figure 3 presents the classifications for different levels of cultural growth. We can see that the deeper we go, the more difficult it can be to change existing practices. The cultural variables are:

- **Values:** Sense of honour and duty
- **Behaviours:** Actions based on beliefs and habits
- **Habits:** Shortcuts made in assessing information lead to habits
- **Beliefs:** Rules of thumb or freeze-dried reasoning can lead to incorrect beliefs
- **Preferences:** Influenced by emotions and psychological experiences

Behavioural economics has taught us that it is the carrot, not the stick that is a powerful motivator to encourage functional behaviour. This also applies to the SM&CR's approach to enforcement and Table 3 provides example strategies that can be employed to ensure firms self-regulate and meet the new Accountability Regime requirements

Figure 3. Levels of cultural growth

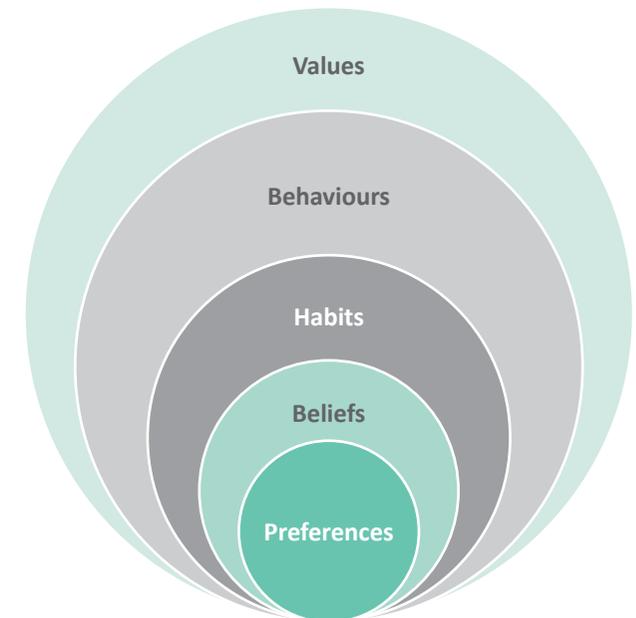


Table 3. Behavioural strategies, actions and outcomes to encourage constructive culture

| Strategy | 'Programmed' behavioural biases | Actions | Outcomes |
|---|---|---|---|
| Governance, moral coding and accountability | <ul style="list-style-type: none"> • Heuristics • Rules of thumb • Bad habits <p>Example: 'It has worked before, it will work again' or 'It's the way we always do things'</p> | <ul style="list-style-type: none"> • Involve and focus staff in designing and implementing corporate value statements • Give all roles and responsibilities buy-in • Diversify skills across SMF and certified roles | <ul style="list-style-type: none"> • Stakeholder adherence to corporate mission, values and philosophy • Alignment between committees and the board • A balance of diversified skills across all SMF and certified roles |
| Nurturing and reward | <ul style="list-style-type: none"> • Risk aversion • Lack of confidence <p>Example: Low self-esteem, poor personal development programmes</p> | <ul style="list-style-type: none"> • Use mentoring, coaching, targeted praise, recognition and measured support through failures and successes • Drive change and continuous improvement | <ul style="list-style-type: none"> • Happy and efficient workforce: self-confidence in abilities, career paths and skills, team ethics, affiliation and sense of pride |
| Endowment theory | <ul style="list-style-type: none"> • Loss aversion • Lack of commitment • Example: Lack of ownership for tasks | <ul style="list-style-type: none"> • Encourage innovation and skill for tasks and activities • Reward appropriately | <ul style="list-style-type: none"> • Ownership and pride for role, responsibilities and tasks in hand |
| Focus on key tasks, roles and responsibilities | <ul style="list-style-type: none"> • Overwhelm • Cognitive dissonance <p>Example: Confused and disjointed behaviour</p> | <ul style="list-style-type: none"> • Pay close attention to tasks in hand, timelines, encourage creativity and small wins • Provide a framework for specific role responsibilities | <ul style="list-style-type: none"> • Efficient engagement with clear activities, low bottlenecks and stagnation, time-bound tasks and creating winning mentality |
| Encourage challenge and risk taking | <ul style="list-style-type: none"> • Inertia and status quo <p>Example: Defaulting to current working practice, just doing enough</p> | <ul style="list-style-type: none"> • Empower staff to ask questions and contribute • Align committee roles e.g. Audit and Risk • Promote continuous improvement | <ul style="list-style-type: none"> • Constructive engagement in challenging conformity, ensuring Treating Customers Fairly (TCF) • Challenge strategic and commercial priorities at board and committee level |

| Strategy | 'Programmed' behavioural biases | Actions | Outcomes |
|--|--|---|--|
| Evidence-based practice | <ul style="list-style-type: none"> Narrow framing 'Halo' effect Group think <p>Example: Defaulting to common consensus or follow the leader</p> | <ul style="list-style-type: none"> Broadly frame the key strategies, operations and tasks against the environment and market Provide sufficient and relevant level of data to committees and boards | <ul style="list-style-type: none"> Engagement of internal and external issues, releases internal and external resources and team potential Evidence and research-based decision-making |
| Effective meetings and appraisals | <ul style="list-style-type: none"> Overconfidence <p>Example: Lack of accountability to systems or controls</p> | <ul style="list-style-type: none"> Maintain a tight agenda, action planning and recording of agreed strategies Track benefits of decisions Communicate systems and controls | <ul style="list-style-type: none"> Justifiable decisions based on evidence Record all discussions and agreed actions Terms of reference or agenda |

THE SENIOR MANAGERS REGIME

This is the most high-profile part of the regime and its aim is to cover only those individuals who have real responsibility, so it is much more focused than the Approved Persons Regime (APER) that it replaces. The issue is that the APER roles that become Senior Management Functions (SMFs) are also covered by the Certification Regime, which firms are charged with managing themselves.

Senior Management Functions (SMFs)

An SMF is a new type of controlled function under the Financial Services and Markets Act 2000 (FSMA). Individuals who hold an SMF are Senior Managers who have the greatest potential to cause harm or impact upon market integrity.

Table 4. SMFs applicable across different SM&CR regimes

| SMFs | Limited | Core | Enhanced |
|---|---------|------|----------|
| SMF1 CEO | | ✓ | ✓ |
| SMF2 Chief Finance Function | | | ✓ |
| SMF3 Executive Director | | ✓ | ✓ |
| SMF4 Chief Risk Function | | | ✓ |
| SMF5 Head of Internal Audit | | | ✓ |
| SMF6 Head of Key Business Area | | | ✓ |
| SMF7 Group Entity Senior Manager | | | ✓ |
| SMF8 Credit Union Senior Manager | | | |
| SMF9 Chair | | ✓ | ✓ |
| SMF10 Chair of Risk Committee | | | |
| SMF11 Chair of Audit Committee | | | ✓ |
| SMF12 Chair of Remuneration Committee | | | ✓ |
| SMF13 Chair of Nominations Committee | | | ✓ |
| SMF14 Senior Independent Director | | | ✓ |
| SMF16 Compliance Oversight | ✓ | ✓ | ✓ |
| SMF17 Money Laundering Reporting Officer | ✓ | ✓ | ✓ |
| SMF18 Other Overall Responsibility | | | ✓ |
| SMF19 Head of Third Country Branch | | | |
| SMF20 Head of Actuarial | | ✓ | ✓ |
| SMF21 EEA Branch Senior Manager | | | |
| SMF24 Chief Operations Function | | | ✓ |
| SMF27 Partner | | ✓ | ✓ |
| SMF29 Limited Scope (Appointment & Scope) | ✓ | | |

Table 5. Example detail for core firm SMFs

| Function Name | Description |
|--|---|
| <i>Governing Functions</i> | |
| SMF1 Chief Executive | The person(s) with the responsibility for the conduct of the business or relevant activities |
| SMF3 Executive Director | A firm director other than a non-executive director |
| SMF27 Partner | A partner, other than a limited partner registered under the Limited Partnership Act 1907 |
| SMF9 Chair | A person with chairing and firm governing body performance oversight responsibilities (can be a non-executive director but all other non-executive directors under APER CF2 will lose approval and lapse) |
| <i>Required Functions</i> | |
| SMF16 Compliance Oversight | A person responsible for the firm’s Compliance Function, formerly a CF10 role |
| SMF17 Money Laundering Reporting Officer | A person with oversight of the FCA rules on anti-money laundering systems and controls |



Action points: For Limited, Core and Enhanced firms

| Key Action Point | Governance Strategies | Risk Management Processes |
|---|---|--|
| ID who the senior managers are | Map an organisational chart across all roles and responsibilities | Know the Senior Management Functions - SMFs |
| Stress-test roles by deeming which events are no one's responsibility | Identify roles and responsibilities and clear job descriptions | Risk register in place to ensure events mapped outside scope |
| Ensure transitions of tasks retain their original priorities. This is crucial for a successful implementation of SM&CR | Consistent handover procedures | Evidence handover procedures and tasks are understood and agreed |
| Committees traditionally rely on collective responsibility, but (below board level) as individuals are accountable, think carefully who is chair for various committees, their terms of reference and how they are recorded | Adequate minutes and evidence for committee decision making procedures and outcomes | Uniform process and templates or minuting recording and evidencing agreed outcomes |
| Ensure SMFs are supported as they carry increased responsibilities | Support process including training and competence requirements | Follow Fit and Proper process and incorporate into Training and Competence programme |
| Align all incentives with the regulators five-step approach to risk management: 1) Who is responsible; 2) How is risk measured; 3) Mechanisms for change; 4) Board oversight; 5) Manage areas that can undermine risk management | Tight control and understanding for remuneration and ensure this is aligned to corporate philosophy and good TCF outcomes | Apply the FCA 5 Conduct Risk questions |
| Hold more than one SMF, but firms will require FCA authorisation for all SMF Function role | Ensure FCA authorization process is in place for each SMF role | Map out roles and responsibilities even if not an enhanced firm |

Statements of Responsibilities

The purpose of a Statement of Responsibilities ([SoR; SUP 10C.11](#)) is to make clear what a Senior Manager is responsible and accountable for. The FCA's desire¹ is to have succinct, clear and accurate SoRs, which reflect individuals' accountability and responsibilities, and it feels that a 'guiding principle' would be beneficial to the introductory text to be used when designing SoRs. SoRs should steer clear of becoming job descriptions or a job profile, i.e. not describe competencies and skills required or how the responsibilities should be discharged. A SoR should focus only on what the role holder is accountable for.

Action point:

Firms need to use 'ARCS' to ensure responsibilities are clear and understood:

- **Actionable** – by the FCA, identifying clear accountability and responsibility
- **Reflective** – of the role, responsibility and work of the individual in relation to that firm
- **Clear** – clearly described accountability and responsibilities
- **Succinct** – only containing relevant information (e.g. not an entire job description)

The record-keeping requirements for SoRs are yet to be announced but past versions would be retained for the length of employment plus seven years to reflect regulatory reference requirements. Preparing and maintaining an up-to-date SoR is a legal requirement for Senior Managers.

The Duty of Responsibility

Every Senior Manager will have a Duty of Responsibility under FSMA. This means that, in the event of a breach, the Senior Manager is held personally accountable if they did not take reasonable steps to prevent or stop the breach. The burden of proof lies with the FCA to show that the Senior Manager didn't take the necessary steps to stop the breach occurring. The [Decision Procedure and Penalties Manual](#) (DEPP) houses the criteria that the FCA use to assess if action needs to be taken.

Core Prescribed Responsibilities

Prescribed Responsibilities (PRs) are specific responsibilities defined in [SYSC 24](#) that a Senior Manager must be given. They are in addition to the Senior Manager role's inherent responsibilities. They DO NOT apply to limited scope firms.

¹ FCA (2018) *Senior Managers and Certification Regime: Proposed guidance on statements of responsibilities and responsibilities maps for FCA Firms*. GC18/4.

Table 6. Prescribed Responsibilities (PRs)

| | Description | Core | Enhanced |
|----|---|------|----------|
| 1 | Performance by the firm of its obligations under the Senior Managers Regime, including implementation and oversight | ✓ | ✓ |
| 2 | Performance by the firm of its obligations under the Certification Regime | ✓ | ✓ |
| 3 | Performance by the firm of its obligations in respect of notifications and training of the Conduct Rules | ✓ | ✓ |
| 4 | Responsibility for the firm’s policies and procedures for countering financial crime risk | ✓ | ✓ |
| 5 | Responsibility for the firm’s compliance with CASS (if applicable) | ✓ | ✓ |
| 6 | Responsibility for ensuring the governing body is informed of its legal and regulatory obligations | ✓ | ✓ |
| 7 | Responsibility for an Authorised Fund Manager’s (AFM’s) value for money assessments, independent director representation and acting in investor best interests AFMs only | ✓ | ✓ |
| 8 | Compliance with the rules relating to the firms’ Responsibilities Map | | ✓ |
| 9 | Safeguarding and overseeing the independence and performance of the internal Audit Function (SYSC 6.1) | | ✓ |
| 10 | Safeguarding and overseeing the independence and performance of the Compliance Function (SYSC 6.2) | | ✓ |
| 11 | Safeguarding and overseeing the independence and performance of the Risk Function (SYSC 7.1.21R & SYSC 7.1.22R) | | ✓ |
| 12 | If the Audit Function is outsourced, ensuring independence between internal and external activity | | ✓ |
| 13 | Maintaining and developing the firm’s business model | | ✓ |
| 14 | Managing internal stress tests and information provided to the FCA | | ✓ |

Action plan Prescribed Responsibilities: Core and Enhanced firms

| Key Action Point | Governance Strategies | Risk Management Processes |
|--|--|--|
| PRs need to be allocated to ‘the most senior person responsible for that issue’, so ensure you allocate each PR to the most appropriate Senior Manager responsible for that activity or areas. Similarly, where a Partner performs an SMF, ensure their activities are clearly set out in their SoR, so think carefully about who is most suitable | Map out all Senior Manager roles and responsibilities and align with clear job descriptions and tasks. Align this with SoRs | Roles and responsibilities should ideally be mapped and reviewed regularly for all firms to ensure they are embedded into the every day tasks and activities |
| The FCA prefers PRs not to be shared, but if so (e.g. job share, job handover or area run by two Senior Managers), then each Senior Manager is accountable and shared responsibilities should be explained in the SoRs (and Responsibilities Map for Enhanced firms) and justified and confirm this does not leave a gap | Align any SoRs with PRs where there are shared responsibilities and ensure there are no gaps in activities between each role and shared PR | Conduct breach and risk register will need to include any shared PR to ensure all activities and tasks are managed correctly |
| Resilience of technology and systems | Research and due diligence process is required to review suitability of technology and systems to enable PRs | Stress testing technology to ensure robust stability and back up/failure supports is essential |
| Reliance on third parties and outsourcing | Map out who is accountable for third parties | Ensure MiFID II ‘Information carriers such as Para-planners or CRMs are trained and have respective PRs |
| Financial promotion accountabilities | Committee accountabilities for such activities need to be evidenced | Ensuring personal accountability and their PR knowledge is crucial |
| Group strategy setting | Ensuring this is clear at both group and local levels | Ensure a seamless accountability process across group and local PRs |
| Budget setting | Ensure that this activity is aligned across both business and SMFs | Ensure a strategy for setting budgets at group level are accountable across Senior Managers |
| Responsibilities mapping | Management responsibility maps need to cover roles and responsibilities, breach strategy including Conduct Rules ‘reasonable steps’ | We would recommend core along with enhanced firms include role responsibility mapping in their responsibility maps |

Fit and Proper Requirements

The FCA Handbook requires that anyone performing an SMF or Certification Function is fit and proper for the role. This includes non-executive directors who are not Senior Managers (except in Limited Scope firms). This includes honesty, integrity and reputation. Records will be required to evidence: Recruitment, processes, regulatory referencing, criminal record checks, civil offences and financial soundness, qualifications, competence and capabilities, training and the overall assessment conclusion.

Governance and Structure

The firm's current governing body and framework can remain. In addition, the SMFs only apply if these jobs exist in the firm; for example, if there is no Chair, there is no requirement to appoint one! It is the same for required functions if your firm is not required to have these roles (note Table 4).

The 12-Week Rule

The Senior Managers Regime allows someone to cover for a Senior Manager without being approved where the absence is temporary or reasonable, unforeseen and the appointment is for less than 12 consecutive weeks.

Outsourcing and the SM&CR

Your firm is fully responsible for carrying out its regulatory obligations, thus if you outsource operational functions (for example, Compliance) you cannot also outsource the accountability for that function.

Conditions

The FCA can set conditions and time limits when approving Senior Managers, plus existing approvals can be changed (e.g. imposing, changing or removing conditions due to remedial actions the firm needs to undertake).

THE CERTIFICATION REGIME

Firms are now required to identify employees who might cause ‘significant harm’ to customers and markets and assess them as fit and proper. This means that it is the firms themselves who are accountable and obligated to self regulate and ensure that they have the right policies and procedures in place to assess this and prevent any harm occurring. Table 7 shows that the Certification Regime not only picks up remaining APER positions but captures a wider range of staff as detailed in [SYSC 27.8](#)

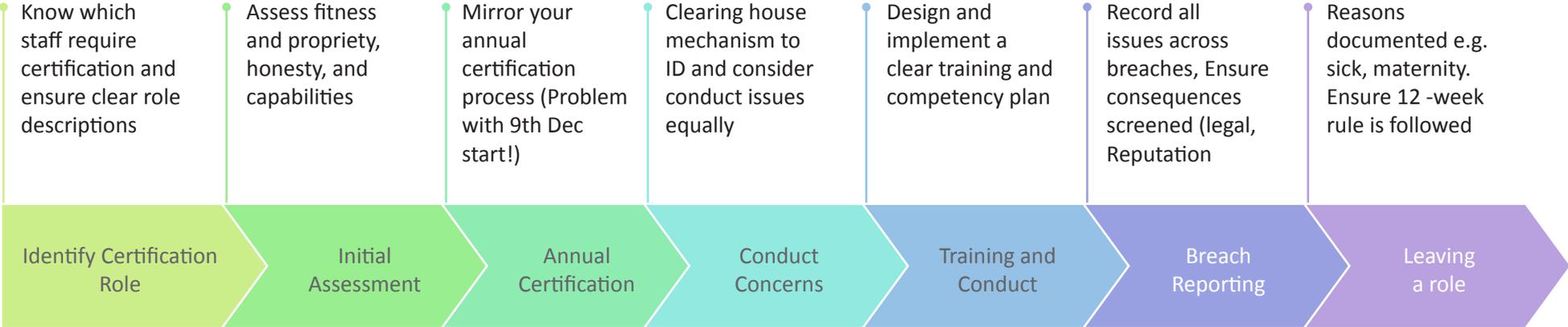
Table 7: Certification Regime Functions

| Function | Approved Person or Equivalent | Description |
|---------------------------|-------------------------------|--|
| Significant Management | CF29 | These functions equate to Significant Influence Function under the existing APER |
| Proprietary traders | CF29 | |
| CASS oversight | CF10a | |
| Subject to qualifications | Various | Staff currently covered by training and competence rules. Roles covered are: <ul style="list-style-type: none"> • Mortgage advisers, • Retail investment advisers, • Pension transfer specialists |
| Client dealing | CF30 | This expands on existing APER requirements and covers any staff dealing with clients including retail, professional clients and eligible counterparties. NB: MiFID II Information givers also require supervision |
| Supervisor or manager | Various | This ensures a clear chain of accountability from junior certified staff to the Senior Manager Function responsible for that area. No gaps in certification are allowed in the reporting chain between certified staff and SMF |
| Material risk takers | Remuneration code staff | Firms need to identify all material risk takers across all risk types (market, credit, liquidity, operational) and include them as certified persons |
| Algorithmic traders | N/A | Includes deployment, usage and monitoring a trading algorithm |

Action plan: The Certification Regime

| Key Action Point | Governance Strategies | Risk Management Processes |
|--|---|---|
| Identify business units and employees that could cause significant harm if a Senior Manager should falter in their duties, employ a Compliance Breach Log and/or Risk Register. This includes Markets in Financial Instruments Directive II (MiFID II) 'Information Givers' such as client managers, para-planners who provide clients with relevant information. They too require supervision under this regime | Know which staff require to be certified and the initial and annual process to do so. | Employ a RegTech diagnostic to map out how other regulations impact the SM&CR and vice versa. |
| Consider the size and significance of the firms business, regulated activities, group and management structure plus any international exposure | Map the business dealings both in the UK and Internationally (if applicable) | Identify any external staff who are classed as material risk takers |
| Take into account BREXIT risks across client needs, communications, product tax and legal requirements, market exposure, counter-party risks and data management | Place systems and controls around all BREXIT related issues and ensure all relevant staff know their responsibilities | Incorporate BREXIT strategies into a risk register and manage accordingly |
| Identify changes to recruitment processes across adverts, descriptions, job offers, employment contracts and regulatory referencing processes. This should include exploration for individual competencies due to the increased scrutiny for certified staff | Map a lifecycle certification process (see figure 4 below) Apply the <u>Fit and Proper test</u> : <ul style="list-style-type: none"> • Obtained relevant qualifications • Undergone/undergoing training • Possesses right level of competence • Has the right personal characteristics | Align staff on-boarding competencies with on-going personal development plans |
| Redesign and implement a training and competency plan (aligned with the breach plan) covering fit and proper assessment procedures including performance management, skill development, disciplinary requirements and the annual appraisal process | Formalise the annual appraisal process to incorporate certification requirements | Ensure a breach process is in place to monitor and assess ongoing conduct |
| Identify and assess all MiFID II classed Information Givers i.e. those in administration roles that may well interact with clients such as Para-planners or client relationship managers and certify as necessary | Map out all relevant staff client engagement responsibilities and activities and align with systems and controls | Use practice management and RegTech to ensure all material risk takers are identified and managed |
| <u>CP 19/4</u> explains those individuals who have no scope to choose or decide and reach judgement on actions and tasks are out of scope | Know which staff are in and out of scope | Align with your roles and responsibilities tasks and plan |

Figure 4: Build a lifecycle process for certification



THE CONDUCT RULES

The SM&CR replaces the Statements of Principles with a two-tier set of Conduct Rules that will be applicable to staff well beyond Senior Management, i.e. they apply to the vast majority of staff in regulated firms, and thus provide the FCA with more powers to take enforcement action and reach deep into a firm.

Table 8: Tier 1 Conduct Rules

| | First Tier – Individual Conduct Rules | Description |
|---|---|---|
| 1 | You must act with integrity | The expectation that individuals deal honestly with their colleagues, customers and regulator |
| 2 | You must act with due care, skill and diligence | Aligned with core competency of each role |
| 3 | You must be open and cooperative with the FCA, PRA and other regulators | Honesty in dealing with the regulator's requests |
| 4 | You must pay due regard to the interests of customers and treat them fairly | This exceeds the Statements of Principles and entrenches principles of treating customers fairly into individual accountabilities |
| 5 | You must observe proper standards of market conduct | Detrimental behaviour such as market manipulation should be avoided on all counts |

Table 9: Tier 2 Conduct Rules

| | Second Tier – Senior Manager Conduct Rules | Description |
|-----|--|--|
| SC1 | You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively | These three conduct rules (SC1, SC2 and SC3) are designed as reasonable steps obligations for firms to ensure that collective steps are taken to control a firm's activities and behaviours to ensure compliance and delegated responsibilities are subject to proper oversight. They all represent a higher duty of care |
| 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 | SMFs are expected to go above and beyond the first-tier rule and proactively notify the regulator of significant matters |

Action plan: The Conduct Rules

| Key Action Point | Governance Strategies | Risk Management Processes |
|---|--|---|
| Identify staff to which the Conduct Rules apply. This isn't as easy as it sounds as the Conduct Rules apply to regulated and unregulated activities including ancillary activities. All Senior Managers, Certified Functions, Non-Executive Directors and all other employees are covered, excluding ancillary staff such as security guards, post room staff, receptionists, data controllers, cleaners, events management, HR administrators | Your roles and responsibilities planning needs to incorporate the conduct rules against each relevant staff members activities and tasks | Know who is IN and who is OUT! |
| Focus on their compliance breach log, identify conduct risks and develop a plan to assess, manage and declare breach types | Evidence process for breach reviews and challenge | Error escalation and rectification processes need to be incorporated into breach and risk registers |
| Redesign their training and competency programme (as per the Certification Regime action point) identifying staff training needs, the Senior Managers' role in supporting conduct, communication process for feedback on conduct issues | Know and apply the conduct lifecycle process (Figure 5) as it applies across the SM&CR conduct journey | Align the Training and Competency programmes to individual staff personal development plans |
| <i>In Relation to 'Reasonable Steps' firms need to:</i> | | |
| Set clear objectives for activities and risk limits | Plan out activities and risk limitation against roles and responsibilities | Risk management framework in place |
| Review and sign off on the procedures for training and competence regime | Align the training and competence programme with governance procedures | Design staff personal development plans with the Training and Competence regime |

| Key Action Point | Governance Strategies | Risk Management Processes |
|---|--|--|
| <p>Ensure regular reviews of risk registers and compliance breach logs. SMFs need to take follow-up steps to understand issues and take corrective action, so receiving information and not responding to 'Red Flags' <u>will not</u> meet the reasonable steps requirement</p> | <p>Apply Governance charts and structure overviews, plus up-to-date terms of reference</p> | <p>Incorporate timely verbal reporting (including meetings with evidence of action points etc.)</p> |
| <p>Ensure any MI is reviewed and covers the full range of activities for which the SMF is accountable</p> | <p>A Governance process is required to collect and assess quality MI and apply this to SMF roles and responsibilities</p> | <p>Use RegTech to track Senior Manager understanding for their activities aligns with Conduct rules</p> |
| <p>Agree actions that need to be taken to ensure that change and decision-making is conducted effectively</p> | <p>Employ strategies that allow:</p> <ul style="list-style-type: none"> • Putting standard procedures in place for authorising changes to business process • Putting standard procedures in place for changing risk limits | <p>Ensure you have a plan for:</p> <ul style="list-style-type: none"> • Providing for oversight and challenge by a committee against SMF activities, ensuring SMFs cannot delegate accountabilities to committees • Minuting disciplines for decisions, including recording information that supports decisions, considered risks, unintended consequences |

| Key Action Point | Governance Strategies | Risk Management Processes |
|--|--|---|
| <p>Hone the art of delegation; as Senior Managers will need to delegate from time to time, care and diligence is required</p> | <p>Due process covers:</p> <ul style="list-style-type: none"> • Delegates have the right skills and experience and these are documented, or if not then training and support is provided to build knowledge along with the relevant supervision • Decision-making authority and limits are clearly defined for the delegate(s) • Regular, formal and documented review meetings are in place between the delegate(s) and SMF • Delegate performance rewards are aligned to the control and compliance elements of the SMF's accountability | <p>Map out and formalize all handover and delegation good practice guidance and ensure all relevant staff have the correct on-going training and competency assessments</p> |
| <p>Training and notification process needs to be in place</p> | <p>Ensure your governance process incorporates:</p> <ul style="list-style-type: none"> • A process to notify all staff and ensure that they are aware of expected role performance • A process to notify the FCA (within seven days) when formal disciplinary action is taken against any member of staff in which his or her breach of a Conduct Rule is an element of the action • An annual notification process for all staff on their training and competence requirements | <p>Ensure all staff know the relevant conduct rules and how they apply to their roles. Check attendance records for on-going Training and Competence purposes.</p> |

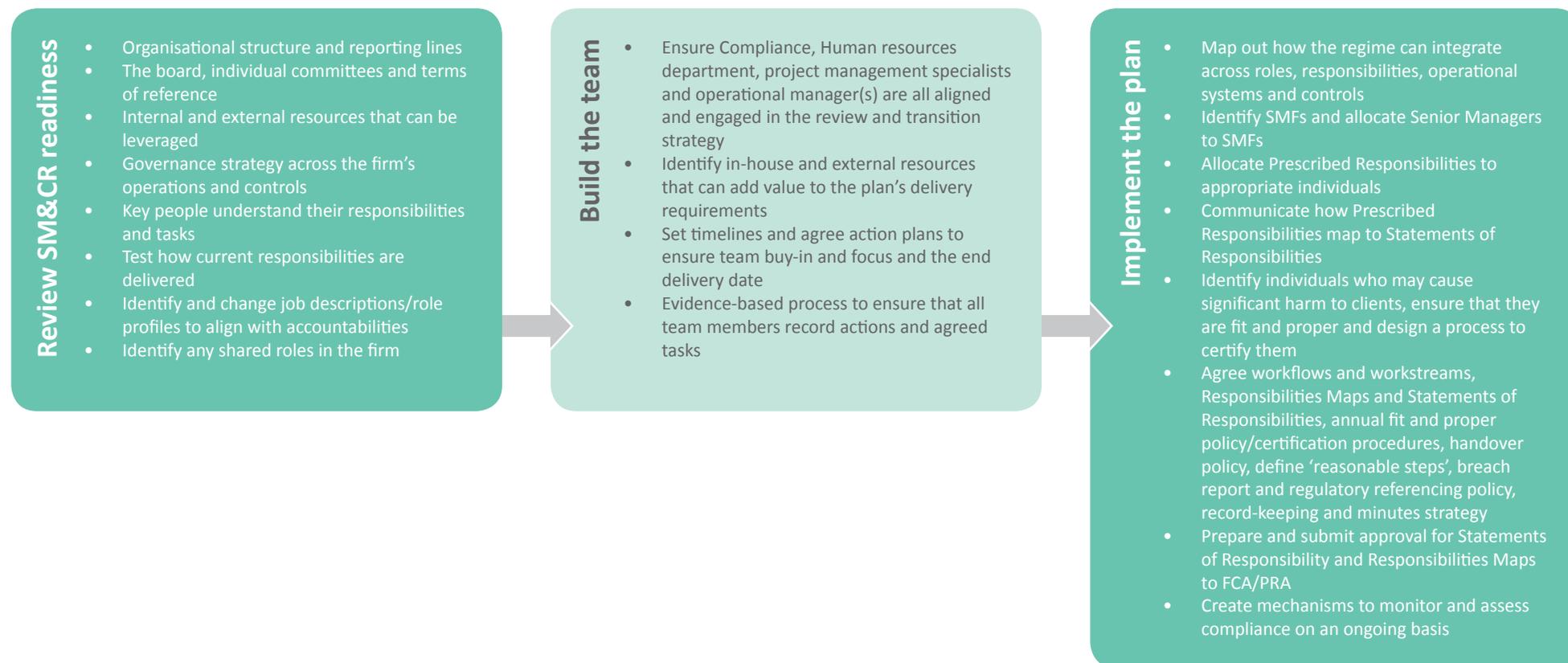
Figure 5: Understand the Impact of conduct on the employee lifecycle



| Process & Policies | Key issues |
|-------------------------|--|
| Recruitment | Job description, reporting lines, Identify SM/ Certified/CR Staff, Check Register/Directory, Handover requirements |
| Training | Competence on Conduct rules and how apply to roles, check attendance and Competence records |
| Assessment & Appraisals | On-going, consistent and fair appraisals, Competence evidenced, Monitor and Attestations, balanced rewards |
| Role change/Promotion | Role change: Revised assessment, SM update SoRs Promotion: Cultural impact, approval process Absence: Planned v unexpected 12-wk rule, deputy arrangements |
| Performance | Measure and improve through diagnostics |
| Disciplinary process | Ensure legal procedures in place, Consequences screened |
| Absences | Log reason (Maternity, sick) 12-wk rule, who will takeover? |
| Exit/Termination | Legal, Consequences, Handover, Reference, FCA notification process |

TRANSITIONING TO THE SM&CR

As we can see, converting individuals from APER to the new regime will need careful planning and processes. The FCA's conversion date for the remaining firms is 9 December 2019, and it is good practice to start planning sooner rather than later. This means designing clear and actionable strategies that can then be blended into your SM&CR implementation project (as an example, see Figure 1).



EXAMPLE CASE STUDIES: HOW THE SM&CR APPLIES ACROSS THE THREE FIRM CATEGORIES

Limited Scope Firm Case Study

| Definition | Key Issues | SMR Requirements | Certification | Conduct Rules |
|--|--|--|--|---|
| <p>Limited Scope Firm: A Small IFA with a Consumer Credit License. This is called a 'Small non-complex firm' by the FCA Syc 24.3.4</p> | <p>This firm is a classic 'one –woman band' with the Director holding a Senior Manager Function. Compliance and Money Laundering need to be covered.</p> <p>There will be no prescribed responsibilities, but It would be good practice to map out responsibilities for the business owner, although not required.</p> <p>Certification is required as the Director advises her clients Training in the Conduct rules needs to be evidenced.</p> | <ul style="list-style-type: none"> • SMF29 Director Level • SMF16 Compliance Oversight • SMF17 Money Laundering Oversight <p>No Requirement to Map Management Responsibilities or submit Statements of Responsibility</p> | <p>The Director requires annual certification across: Significant management function Client Dealing Function Material Risk Takers</p> | <p>Apply to all individuals that are (in any way) involved in financial service activities. Training is required in The Conduct Rules. Prescribed Responsibilities do not apply</p> |

Core Firm Case Study

| Definition | SMR Requirements | Certification | Conduct Rules |
|--|---|---|--|
| <p>Core Firm: A Retail Investment Advice Firm with Wealth Management (non client Money holding) and Mortgage Permissions 10 Advisers 2 Executive Directors 1 Board Chair and NED</p> | <p>SMF27 Partner Function will not apply (as LTD) SMF3 Executive Director Function</p> <ul style="list-style-type: none"> • SMF1 CEO • SMF9 Chair (NED) • SMF16 Compliance Oversight & • SMF17 Money Laundering Oversight are held by one person <p>Each Senior Manager should be allocated one of the appropriate Core Tier Prescribed Responsibilities (PRs) (The FCA prefers PRs not to be shared). Statements of Responsibility and Responsibility and Role Mapping (although both not required) are considered good practice to apply to SMFs.</p> | <p>Individuals Advising on Investments and Mortgages will require Certification due to:</p> <ul style="list-style-type: none"> • Function Qualifications • Client Dealing Function • Material Risk Taker Function <p>Exec Directors who advise require certification for:</p> <ul style="list-style-type: none"> • Significant Management Function (Currently CF29) and completed via Fit & Proper assessment of SMFs <p>(Non Senior Manager) Managers will require certification</p> | <p>All staff involved in or connected to financial service activities are required to be trained in how the Conduct Rules apply to their roles. The Senior Manager allocated The Conduct Rules Prescribed Responsibility (PR) should ensure firm training and is responsible for Conduct Rule breach recording and reporting</p> |

Enhanced Scope Firm Case Study

| Definition | SMR Requirements | Certification | Conduct Rules |
|---|---|---|---|
| <p>Enhanced Firm: A Bank with full CASS permissions, Wealth Management, Lending and Saving permissions 1 CEO 8 C-Suite Executives 300 staff</p> | <p>Enhanced SMFs apply in addition to the above Core SMFs:</p> <ul style="list-style-type: none"> • SMF2 Chief Finance Function • SMF4 Chief Risk Function • SMF5 H/o Internal Audit Function • SMF10 Chair Risk Committee Function • SMF11 Chair Audit Committee Function • SMF12 Chair Remuneration Committee Function • SMF14 Senior Independent Director Function • SMF24 Chief Operations Function <p>Mapping Management roles and responsibilities is required along with allocating Statements of Responsibility</p> | <p>Individuals are responsible for a wider range of functions across:</p> <ul style="list-style-type: none"> • Client Dealing Function • Material Risk Takers • Manager of individuals performing certification functions • CASS Oversight <p>The Senior Manager allocated the Certification Prescribed Responsibilities need to ensure they are assessed as Fit and Proper at least annually</p> | <p>As per Firm 2 All staff involved in or connected to financial service activities are required to be trained in how the Conduct Rules apply to their roles.</p> <p>Ancillary staff will not need to be trained</p> <p>The Senior Manager allocated the Conduct Rules Prescribed Responsibility (PR) should ensure firm training and is responsible for Conduct Rule breach recording and reporting.</p> <p>The Senior Manager(s) will be held accountable via a Duty of Responsibility to take reasonable steps to prevent or stop the breach</p> |

HOW MODEL OFFICE-MO® CAN HELP SUPPORT YOUR SM&CR JOURNEY

Regulation technology (RegTech) can help you gain valuable MI on your business, and track activities that require attention plus provide resources that can be used for you to comply and remain competitive in an ever-demanding marketplace.

MO® has been designed to allow firms to self-audit their business against key regulations, and benchmark against the good outcomes the FCA is aiming for, along with understanding how firms rank against their peers. The system benchmarks across the five key areas we focused on in the Introduction:

1. Your focus: Assesses your compliance activities, systems and controls across key regulatory directives
2. Your engagement: Investigates client and stakeholder engagement across marketing, documents, the client journey
3. Your promise: How your proposition research and due diligence meets regulatory requirements
4. Your systems: Focuses on practice management across business, client management and administration workflows
5. Your people: Ensures Human Resource development procedures meet APER and the SM&CR

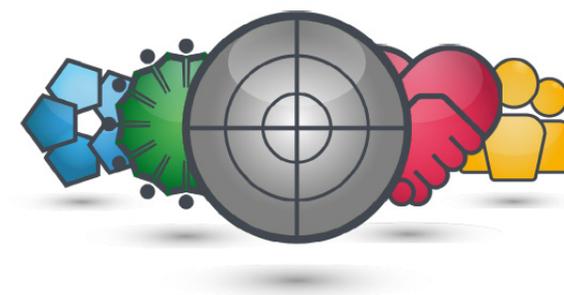
The regulatory dashboard of **MO®** provides a balanced scorecard across all five key areas, along with tailored, prioritised tasks and resources such as templates for the firm to action to ensure that they understand, measure and manage all key regulatory and business development challenges they face. The platform also employs a digital compliance Chat Bot offering guidance and support to improve compliance scores.

The system will help firms to cut through the industry noise, identify problems early and focus on key tasks that are required to ensure high compliance, a client focus and sustained professional practice.

In relation to helping firms meet their SM&CR requirements, **MO®** will:

- Ensure teams have the right information to build their implementation plan
- Provide templates across
 - Roles and Statements of Responsibilities
 - FCA reporting and certification requirements
 - Breach reporting policy
 - Defining 'reasonable steps'

For more information please contact us at: info@model-office.co.uk



SUMMARY

One of the key conundrums with the SM&CR is individual responsibility versus the duty of the firm. As we can see, the onus is on individual responsibilities for executing SMF and/or Certification Function duties. Tension may arise if any individual argues that the firm has not provided appropriate guidance or tools to discharge responsibilities. The FCA is untested here and time will tell. However, this regime provides the FCA with deeper penetration into individual activities and behaviours so it will be the individuals who are held to account. For example, the Duty of Responsibility doctrine requires all SMFs to demonstrate that they have taken 'reasonable steps' to ensure the sound running of their part of the business.

Another example for the personal nature of this regime is the Senior Manager Conduct Rule that requires SMFs to disclose appropriately any information of which the regulator would expect notice. This takes Principle 11 of the Principles for Business, which applies at the firm level, and makes it a personal obligation on individual SMFs.

As ever with the regulator, disclosure is crucial to ensure compliance and trust. This means those individuals (not firms) whom the FCA see as uncooperative in disclosing relevant information relating to a breach will face strong disciplinary action. This duty to notify expands from compliance and becomes the individual responsibility of the relevant Senior Manager. This means training and competence take on a huge role in ensuring SMFs and certified staff know exactly what to do in relation to engaging their responsibilities and the FCA.

Watch out for our next papers in this 'Unwrapped' series:

The Senior Managers Regime Unwrapped

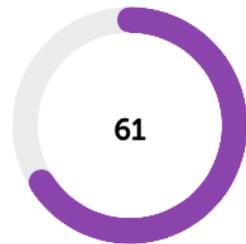
The Certification Regime Unwrapped

The Conduct Rules Unwrapped

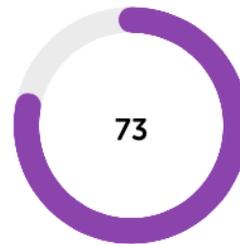
The SM&CR Implementation and BAU Unwrapped

-  Home
-  Your Focus
-  Your Engagement
-  Your Promise
-  Your Systems
-  Your People
-  History

means you need to stay on your toes and ensure people are happy and in the right roles so that the business performs well, efficiently and effectively.



Your Score



Industry Benchmark



One Year

IMPROVING YOUR SCORE

Click on each business function below to provide more resource and context on each area MO assesses your compliance people development against and receive MO's guidance and dynamic steers to support your score improvement

| | | |
|---|--|---|
| Organisational structure ● | Induction programme ● | Competencies ● |
| Professionalism ● | Reward and recognition ● | Performance management ● |
| The Senior Managers and Certification Regime ● | Recruitment ● | Staff learning and development programme ● |
| Compensation and benefits ● | Staff engagement and feedback ● | Position descriptions ● |

Compliance Chat ▼

Hi Chris, how can I help?

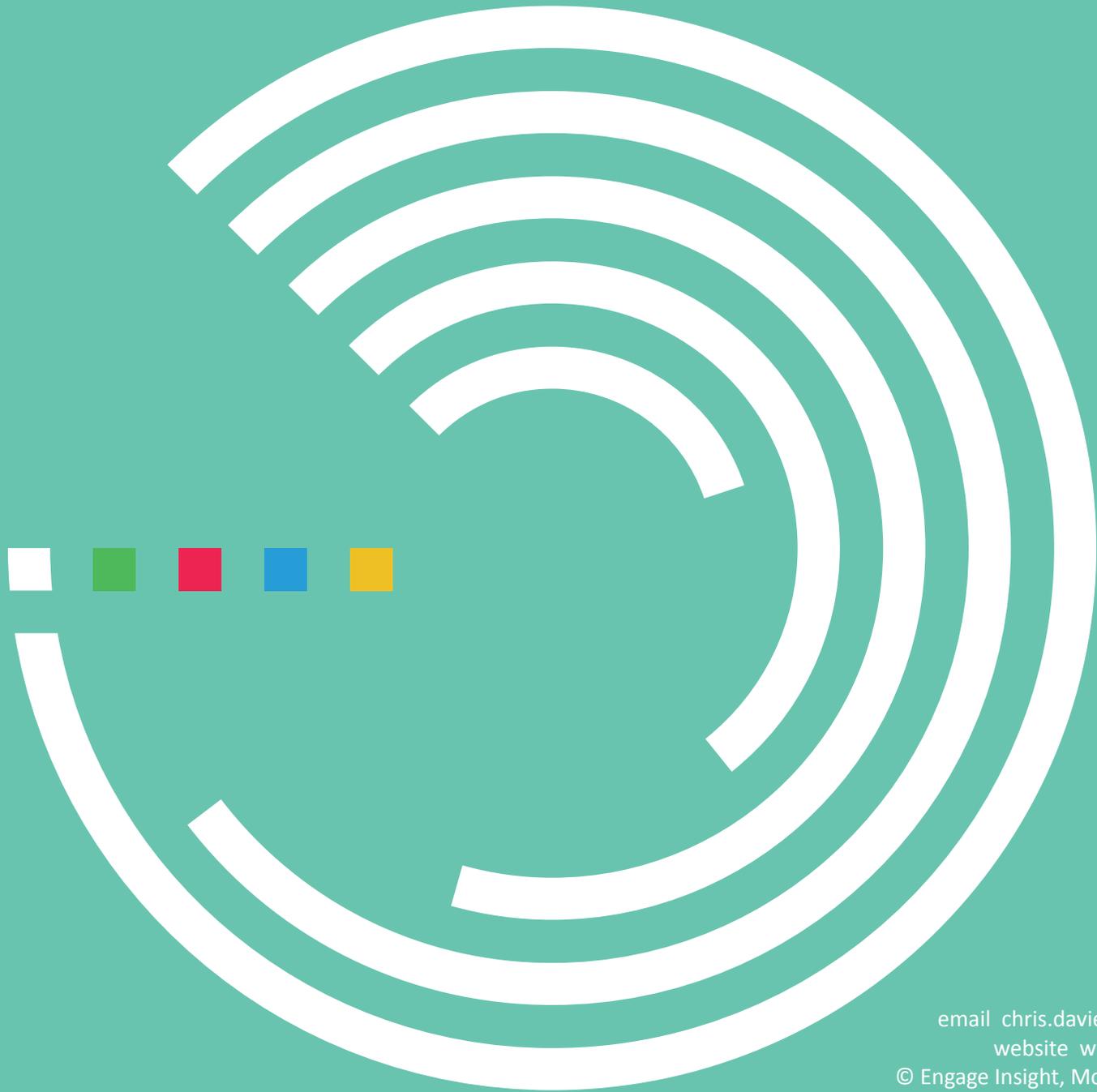


The SM&CR is a new framework to assess fitness, propriety, conduct and accountability standards for individuals holding responsible positions within financial service firms. The rules currently apply to PRA investment firms (banks and some insurers), but they will soon apply to [all regulated firms](#). There are three main pillars: 1. Senior Managers Regime: Senior management functions apply to certain firms. Check out [SYSC](#)

Send a message...

TERMS USED IN THIS REPORT

| Term | Description |
|---------------------------------------|---|
| Ancillary Staff | Employees who are not covered by the Conduct Rules such as security, cleaners, receptionists etc |
| Certification Function | A function performed by employees who could pose a risk of significant harm to the firm or its customers. The FCA do not approve people for these functions |
| Certification Regime | This covers Certification Functions |
| Criminal Records Check | A firm requirement to undertake criminal record checks for Senior Managers and Non-Executive Directors (where a fitness requirement applies) as part of checking Fit and Proper status |
| Duty of Responsibility | Every Senior Manager will have a Duty of Responsibility as a result of FSMA. This means that if a firm breaches one of The FCA 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 |
| 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. |
| Handover Procedures | A firm must take all reasonable steps to make sure a new Senior Manager has all the information and materials they need to do their job. |
| Overall Responsibility | A requirement for every area, activity and management function of the firm to have a Senior Manager with overall responsibility for it. |
| Prescribed Responsibilities (PR) | FCA-defined responsibilities that must be allocated to an appropriate Senior Manager |
| 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). |
| Responsibilities Maps | A document setting out a firm's governance and management arrangements, and how responsibilities are allocated to individuals within the firm. |
| Senior Management Functions (SMFs) | The roles where the people doing them need to be approved by the FCA. These are defined in The FCA Handbook. |
| Senior Managers | The people who perform a SMF. These people need FCA approval to do their jobs. |
| Senior Managers Regime | The part of the regime for Senior Managers. This includes SMF, SoRs, Duty of Responsibility, Fit and Proper, PRs, Regulatory References and criminal records checks. For Enhanced Firms, it also includes Responsibilities Maps, Handover Procedures and Overall Responsibility. |
| Statements of Responsibilities (SoRs) | 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 when there is a significant change, and be kept up to date. |



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