STRENGTHENING ACCOUNTABILITY IN BANKING
A NEW REGULATORY FRAMEWORK FOR INDIVIDUALS
SEPTEMBER 2014
# CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTRODUCTION</td>
<td>2</td>
</tr>
<tr>
<td>OVERVIEW</td>
<td>3</td>
</tr>
<tr>
<td>SENIOR MANAGERS REGIME</td>
<td>4</td>
</tr>
<tr>
<td>THE CERTIFICATION REGIME</td>
<td>8</td>
</tr>
<tr>
<td>CONDUCT RULES</td>
<td>10</td>
</tr>
<tr>
<td>UK BRANCHES OF OVERSEAS FIRMS</td>
<td>13</td>
</tr>
<tr>
<td>KEY RISKS AND PLANNING</td>
<td>14</td>
</tr>
<tr>
<td>TEAM PROFILES</td>
<td>17</td>
</tr>
</tbody>
</table>
The final report of the Parliamentary Committee on Banking Standards criticised not just the "firewall of accountability" around senior individuals within banks but also the regime designed to regulate them. It launched the design of a new regulatory regime for individuals, which the Prudential Regulation Authority ("PRA") and Financial Conduct Authority ("FCA") (together, the "Regulators") say will create "a new framework to encourage individuals to take greater responsibility for their actions" and will therefore make it easier for Regulators to hold them to account.

The joint Consultation Paper "Strengthening accountability in banking: a new regulatory framework for individuals" (FCA CP14/13/PRA CP14/14) sets out the Regulators' proposals for new rules governing individuals, which extend both the depth and breadth of regulation. Senior individuals will be regulated more closely, with the Senior Managers regime requiring a granular analysis and record of their responsibilities. Meanwhile the Conduct Rules and Certification Regime broaden the net of individuals who are directly accountable to the Regulators.

This paper identifies the key changes proposed and explores some of the enormous organisational, structural, system, resourcing and cultural changes that firms need to start considering and planning in order to meet these new requirements effectively.
OVERVIEW

PRA CP14/14 – FCA CP 14/13

Implements Part 4 of the Financial Services (Banking Reform) Act 2014
- Senior Management functions
- Statements of Responsibilities
- Approval, conditions/restrictions
- Notifications
- Reverse burden, criminal offence
- Annual certification
- Conduct rules

Introduces:
- Responsibilities Map
- Handover certificates
- References obligation

To come: branches of non-UK banks

Employment implications
- Statement of Responsibilities/job descriptions
- Attestations, certificates
- Handover issues
- References and notifications
- Impact on bonus/appraisal
- Legal advice
- Due diligence

Next steps
- Consultation closes 31 October 2014
- Further technical consultation
- Finalised rules Q1 2015

Significant implementation challenge

Senior Managers (SMs) in scope
Firm’s Board and Board -1 level; also:
- Group entity Senior Manager
- Key Business Area Heads
- Heads of Risk and Internal Audit, Compliance oversight, MLRO,

Uncertainties around prescribed responsibilities, shared responsibilities
Collective Board responsibility

Annual certification of persons carrying on significant harm functions (CPs) – fit and proper test

- Specified functions
  - CASS oversight
  - Benchmark roles
  - Senior control functions
  - Heads of Legal, Finance, HR, IT, Remuneration, Economic analysis
  - Customer functions
  - Significant responsibilities – EBA material risk takers
  - All managers of CPs (except SMs)

Responsibilities Map – a single document, a responsible senior manager

- Dynamic, up to date, kept for 10 years
- To cover all prescribed responsibilities, approved persons, senior management, senior personnel
- Reporting lines, lines of responsibility
- Split of responsibility if shared
- Details of governance arrangements in main business lines and management functions

- Details of capital and risk governance
- Matters reserved to governing body
- Lines into Group or a 3rd party
- Person responsible for SMCR performance
- Annual certification as to compliance to be approved by Board

Conduct rules
For all employees* (not ancillary staff)
- 6 months for SMs and CPs; 12 months for remainder
- conduct re activities as SM or employee of firm
- overseas-based, PRA-only, CPs not subject to FCA specific rules
- new FCA TCF rule
Key Purpose

"A new 'Senior Managers Regime' for individuals who are subject to regulatory approval, which will require firms to allocate a range of responsibilities to these individuals and to regularly vet their fitness and propriety."\(^1\)

- The Senior Managers Regime (SMR) replaces the concept of a Significant Influence Function with a Senior Management Function (SMF), and is to be managed as a single regime by the PRA and FCA.
- The SMR ensures that major activities, responsibilities and risks of the firm’s affairs are clearly allocated by firms to key individuals within, or thereby brought within, the SMR, leading to enhanced individual accountability.
- Any individual performing an SMF will require approval by the PRA / FCA.
- Ultimate authority over, and decision-making power of, a firm will remain with its board/governing body acting collectively.

Scope

The functions which each of the PRA and FCA consider to be SMFs differ slightly from one another, reflecting the statutory objectives of each regulator. The list of functions to be designated as SMFs by the Regulators is as set out below.

<table>
<thead>
<tr>
<th>Combined list of Senior Management Functions</th>
<th>Combined list of Senior Management Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief Executive function(^2)</td>
<td>Chair of the Risk Committee</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF1</td>
<td>PRA &amp; FCA SMF10</td>
</tr>
<tr>
<td>Chief Finance function(^2)</td>
<td>Chair of the Audit Committee</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF2</td>
<td>PRA &amp; FCA SMF11</td>
</tr>
<tr>
<td>Executive Director</td>
<td>Chair of the Remuneration Committee</td>
</tr>
<tr>
<td>FCA only SMF3</td>
<td>PRA &amp; FCA SMF12</td>
</tr>
<tr>
<td>Chief Risk function</td>
<td>Chair of the Nominations Committee</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF4</td>
<td>FCA only SMF13</td>
</tr>
<tr>
<td>Head of Internal Audit</td>
<td>Senior Independent Director</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF5</td>
<td>PRA &amp; FCA SMF14</td>
</tr>
<tr>
<td>Head of key business area(^3)</td>
<td>Non-Executive Director</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF6</td>
<td>FCA only SMF15</td>
</tr>
<tr>
<td>Group Entity Senior Manager(^4)</td>
<td>Compliance Oversight</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF7</td>
<td>FCA only SMF16</td>
</tr>
<tr>
<td>Credit union SMF (small credit unions only)</td>
<td>Money Laundering Reporting</td>
</tr>
<tr>
<td>PRA &amp; FCA SMF8</td>
<td>FCA only SMF17</td>
</tr>
<tr>
<td>Chairman(^5)</td>
<td>Significant Responsibility SMF(^6)</td>
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<tr>
<td>PRA &amp; FCA SMF9</td>
<td>FCA only SMF18</td>
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\(^1\) Consultation Paper, paragraph 1.2

\(^2\) Every firm (other than a small credit union) will be required to have one or more persons performing this SMF.

\(^3\) This SMF is to be assigned to individuals managing a business area or division so large in relative terms to the size of the firm that it could jeopardise its safety and soundness and so substantial in absolute terms that it warrants an SMF, even though the senior manager performing it may report to the Chief Executive or another SMF.

\(^4\) An individual who is employed by a parent or other entity in the same group as the firm but deemed to exercise ‘significant influence’ over the firm’s affairs is also subject to approval. Please refer to the section on UK branches of overseas firms.

\(^5\) Every firm (other than a small credit union) will be required to have one or more persons performing this SMF.

\(^6\) Any individual who has overall responsibility for one or more Key Functions (as set out by the FCA) with responsibility for reporting to the Board in respect of that function but whose role is not otherwise an SMF.
It is important to note that the SMFs are cumulative, rather than mutually exclusive: all PRA functions are also FCA functions. The ‘prescribed responsibility’ (see below) for making sure that the firm complies with the structures and organisation required by the Senior Managers regime must be allocated to a Senior Manager. Nonetheless, the Regulators will retain the ability to engage with and take enforcement action over a Senior Manager, if required.

Individuals intending to perform more than one SMF will require approval for each SMF, which may be sought in a single application. It will be possible for a firm to have more than one individual approved to perform an SMF, in which case each individual approved will be accountable for all of the responsibilities conferred on that SMF. These individuals will want to take particular care over the drafting of their statements of responsibilities given this overlap, and to have a clear understanding of how the responsibilities will be shared.

Prescribed Responsibilities (PRA)

The PRA's draft rules define each SMF by reference to the responsibility inherent in that function.

In addition the PRA proposes to make rules setting out a number of ‘Prescribed Responsibilities’ (of which there are currently 20) which firms will be required to allocate among their Senior Managers approved by the PRA or FCA. It is likely that firms will wish to allocate each Prescribed Responsibility to the Senior Manager carrying out the SMF with which the responsibility is most closely associated. Examples of Prescribed Responsibilities include:

- Performance by the firm of its obligations under the senior management regime, including implementation and oversight.
- Compliance with the rules relating to the firm's management responsibilities map (see later section).
- Leading the development of the firm's culture and standards in relation to the carrying on of its business and the behaviours of its staff.

The interpretation of the definitions for responsibilities in the proposed PRA and FCA rules will require careful legal analysis to ensure a firm satisfies all obligations under the SMR.

Key Functions (FCA)

In addition to the responsibilities assigned to Senior Managers by the definitions contained within the PRA's draft rules, and the Prescribed Responsibilities to be allocated to Senior Managers by the PRA, the FCA has identified 27 ‘Key Functions’. If an individual has overall responsibility for any of these functions, they will be performing an SMF and will require approval, over and above the SMFs listed above. This is another example of the FCA's rules being cumulative to the PRA's rules, and relevant firms will have to comply with both.

A firm will not be expected to appoint a different individual as an SMF in respect of each of these functions. Rather one SMF will be likely to have several Key Functions for which he or she is responsible. These matters all increase the administrative and organisational burden of recording, monitoring, and updating the allocation of responsibilities. Examples of functions identified as Key Functions include:

- Establishing and operating systems and controls in relation to financial crime
- Investment Management
- Customer Service
- Human resources

The ambiguity and wide scope of these ‘Key Functions’ will present risks in interpretation and will require careful legal analysis to ensure a firm satisfies all obligations under the SMR.

A complete list of PRA prescribed responsibilities and FCA key functions is available here.

Key Deliverables

Fitness and propriety

Amendments to FSMA have introduced a legal requirement for firms to satisfy themselves, before applying for the approval of an individual, and at least annually following approval, that the candidate is fit and proper to perform the
function to which the application relates. This obligation extends to ensuring that Senior Managers have appropriate qualifications, training, competence and personal characteristics to perform their relevant function(s). Firms will be required to obtain documentary evidence to support their conclusions, including criminal checks and previous employer references. As now, firms will also be subject to a regulatory duty to provide all relevant information when asked for a reference in respect of a current or former employee.

**Statements of responsibilities**

The PRA and FCA both require firms to ensure that any application for the approval of an individual to perform an SMF is accompanied by a formal statement of responsibilities.

If there is a significant change in the responsibilities of that Senior Manager, the statement of responsibilities should be updated and resubmitted to the relevant Regulator. The statement of responsibilities must set out any PRA or FCA prescribed responsibilities allocated to the individual as part of their responsibilities.

The meaning of "significant" is not fully explored in the CP, but it is clear that maintaining up to date statements of responsibilities, and putting in place the HR, IT and role-tracking reporting tools to identify when a Senior Manager's responsibilities change, will present a huge practical challenge to firms and may require dedicated resource.

**Responsibilities map**

The PRA and the FCA also both require firms to prepare, maintain and update a single "document" which describes all of the firm's management and governance arrangements, including:

- Details of reporting lines and lines of responsibility;
- The scope of any delegation of responsibilities by senior managers, and consequential amendments to reporting lines. Senior Managers will remain accountable for the actions of delegates. The third Senior Manager Conduct Rule requires Senior Managers to "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". This will need to be reflected in the responsibilities map; and
- Reasonable details about the persons who are part of those arrangements and their responsibilities.

The responsibilities map should also include:

- how responsibilities are allocated, including if they have been allocated to more than one person;
- the names of the firm's approved persons and details of the responsibilities which they hold; and
- all responsibilities described in any current statement of responsibilities.

The task will be complex: most firms currently struggle to keep organisation charts up to date. The responsibilities map will be significantly more complex than organisation charts: they will have to record a greater quantity of information accurately, and be updated as the position changes, and old versions must be retained. Responsibility for ensuring the firm complies with the rules relating to this document must be allocated to a Senior Manager.

A firm must certify in writing at least once every 12 months that it has complied with the requirement to maintain a responsibilities map and if not, why not. The firm's management body must approve the content and issuance of the annual certification and it must be signed on behalf of the management body.

These changes will present significant governance challenges for large firms, and are likely to require dedicated resource.

**Sanctions**

**Enforcement**

The PRA and FCA aim to make clear the consequences of poor practice and will continue to use existing enforcement powers to hold senior individuals to account for failings in relation to this documentation.
Presumption of responsibility / reversed burden of proof

If a firm contravenes a relevant requirement, the Senior Manager who holds responsibility for the area where the contravention has occurred (as determined by the individual's statement of responsibilities and the firm's responsibilities map) will be deemed guilty of misconduct unless they can demonstrate to the regulator's satisfaction (on a balance of probabilities) that they took reasonable steps to prevent, stop or remedy the relevant breach. Failing this, they may face individual sanctions.

Before the reverse burden is engaged, the regulator must establish (on a balance of probabilities) that

- the person was a senior manager;
- the firm has contravened a relevant requirement; and
- the senior manager was responsible for managing the relevant part of the business in which the contravention occurred.

The statements of responsibilities and the responsibilities map will effectively provide the regulator with evidence in respect of the first and third of these requirements. Where a regulator has previously taken action against the firm, and a Final Notice has been issued, that action will be relied upon to evidence the regulatory contravention by the firm.

It is therefore possible that, going forward, firms may be less willing to settle regulatory actions early where this would leave their senior managers exposed to disciplinary action and facing a reversed burden of proof.
THE CERTIFICATION REGIME

Key purpose

- The Certification Regime implements the amendment to FSMA which empowers the FCA and PRA to specify "significant harm functions". These will be referred to as "certification functions". The aim is to extend the range of people who can be held personally responsible beyond those currently covered by the Approved Persons regime. Individuals within the Certification Regime will not be subject to regulatory approval — instead, the duty is on firms to: (a) review and renew certification of such employees annually; and (b) take reasonable care to ensure no employee performs such a function without first being certified by the firm as fit and proper to do so.

Scope

PRA - The PRA's focus is on those functions which could involve a risk to the safety and soundness of the firm. It is therefore basing the scope of those individuals to be certified (referred to by the PRA as 'significant risk takers') closely on the criteria used to define 'material risk takers' under the Capital Requirements Directive and Regulation ((EU) No 604/2014 (CRD IV)), in particular in Articles 3 to 5. Those provisions have been further supplemented by the European Banking Authority's Regulatory Technical Standard on the qualitative and quantitative criteria for a "material" risk taker.

Individuals identified as material risk takers in the joint Consultation Paper, "Strengthening the Alignment of Risk and Reward: New Remuneration Rules" (PRA CP 15/14; FCA CP14/14), are those deemed by the firm to have a material impact on the firm's risk profile. Firms should therefore already be able to identify the population of material risk takers in order to ascertain those who should be certified.

The PRA has said that not every individual classified as a material risk taker will necessarily fall within the Certification Regime. Individuals must also meet the statutory test for a certification function. The Consultation Paper provides the following examples of persons who will fall outside the definition:

- someone who is a Senior Manager or performs any other Controlled Function for a firm;
- individuals whose functions are not related to the regulated activities of the firm; and
- individuals temporarily appointed solely to provide cover for a certified employee whose absence is reasonably unforeseen, provided the cover is for less than 2 weeks. This exception does not apply if the certified function requires the individual holding it to gain a professional or other formal qualification.

FCA - The FCA also considers 'material risk takers' should fall within the scope of its Certification Regime, provided that those individuals are not also performing a Senior Management Function. However, in light of its focus on conduct and consumer protection, the FCA (unlike the PRA) will only require employees to be certified if they perform their function from an establishment in the UK or are outside the UK but are "dealing with a UK client". More could be done to clarify the nature and degree of contact with UK customers that a person operating from outside the UK must have in order to fall within scope.

In addition, the FCA has designated a number of additional roles as significant harm functions because they may cause harm to customers. In particular:

- Individuals performing functions that would formerly have been Significant Influence Functions, but which are not now within the scope of the new SMFs regime. FCA has said that this comprises significant management functions, proprietary traders currently under CF29, client assets oversight (CF10a) and benchmark submission functions.

- Individuals in customer-facing roles subject to qualification requirements as set out in the FCA's Training and Competence (T&C) Sourcebook. The FCA wants proper checks on these qualifications. It is important to note that, as currently proposed, those currently performing CF30 functions will not require FCA approval under the new regime, and furthermore that many current CF30s will not fall within the certification regime either (not being subject to T&C requirements). It remains open to the FCA under the new regime to continue to specify controlled functions that are not SMFs, although at present it has chosen not to do so.

- Anyone supervising or managing a Certified Person (provided that person is not also an SMF holder), since they will have influence over how Certified Persons carry out their roles. Examples will be heavily dependent on the firm's reporting structures.
Main responsibilities

The Regulators expect firms to put in place a single process for certifying each employee who falls within either regulator’s regime, and to make a single assessment and issue a single certificate to a relevant employee in respect of a particular certification function. If an individual performs multiple certification functions, they will need to be assessed for each function separately according to those applicable standards, but can be covered by issuing a single certificate.

Again, it is important to note that the FCA obligations are cumulative to the PRA requirements, and so firms will need to consider and apply both sets of rules in respect of many individuals.

Assessing fitness and propriety

Firms should assess fitness by reference to the existing general rules around the qualifications, training, competence and personal characteristics required by an individual in that role: the key change is that the firm must take on the primary duty of assessing fitness and propriety, rather than the Regulator. The regulator will not maintain a public register of certified persons, as they currently do for approved persons, and firms will no longer be required to file the “form” based information with the regulator about an individual. As such, firms will be dependent on other employers directly for information about a new employee, rather than reverting to the FCA. Firms should refer to the FCA’s FIT sourcebook that currently applies to the approved persons’ regime for guidance on how to assess fitness under the new regime.

The PRA currently relies on FIT and has not yet developed bespoke rules around fitness and propriety. It proposes to create new rules in the form of a supervisory statement.

Key Deliverables

Firms must implement:

- an annual Certification Process
- a renewal of the certification process each time an individual moves from performing one role to a different one within the Certification Regime (whether FCA or PRA).

It is likely that larger firms will require dedicated staffing to design, maintain and periodically renew the firm’s certification process. There will need to be a clear program for ensuring that staff are fully trained and aware of their responsibilities. This may include:

- review and enhancement of internal training as well as consideration of the need for further or enhanced external training;
- enhanced HR systems and staffing to track more closely and in real time changes to staff by reference to certification roles to ensure appropriate notifications are made – and most importantly to ensure the firm has certified staff before they begin to perform such roles; and
- consideration of how to co-ordinate this process with the firm’s response to the Lambert recommendations on banking standards, and any reporting the firm makes to the new Banking Standards Review Council.

Firms are expected to have identified all individuals who will be covered by the certification regime at commencement, but will have 12 months to issue individuals with a first certificate of fitness and propriety under the new regime. There will be some element of “grandfathering” of existing approved persons, but further guidance and confirmation from the Regulators is awaited.

Sanctions

FSMA requires firms to take reasonable care to ensure that a person does not perform a certification function without having been certified as fit and proper. In the event of a breach, the individual Senior Manager responsible for compliance with the Certification Regime could be at risk if unable to show reasonable steps taken to ensure the firm was compliant with the rules.
Key Purpose

The new Conduct Rules will form part of the Regulators’ supervision of firms and will provide a framework against which Regulators will make judgements about an individual’s actions.

Scope

The Conduct Rules are intended to cover all individuals within relevant firms who are in a position to have an impact on the Regulators’ respective statutory objectives.

PRA – The PRA’s Conduct Rules will apply to all individuals approved by the PRA or FCA as Senior Managers or who fall within the PRA’s Certification Regime. The PRA considers that these are the individuals who would be able to impact the PRA’s statutory objectives.

FCA - The FCA’s Conduct Rules will apply to all individuals who would be in a position to impact its statutory objectives, especially those of protecting consumers and market integrity. This will capture the majority of individuals working in relevant firms including:

- all individuals approved by the FCA or PRA as Senior Managers
- all individuals covered by the Certification Regime
- all other employees apart from ancillary staff who perform a role that is not specific to the financial services business of the firm. These roles are to be defined by exception.

Main Responsibilities

As recommended by the PCBS, the Conduct Rules will ‘draw on the existing principles’ by using the Statements of Principle and Code of Practice for Approved Persons (APER) and Principles for Businesses (PRIN) as their basis. The proposed rules therefore draw on the Regulators’ experiences of enforcing APER and PRIN, and the approved persons’ experience of complying with them. The rules are set at a high level as they will cover a large range of people doing a wide range of different jobs.

<table>
<thead>
<tr>
<th>Rule</th>
<th>Regulator</th>
</tr>
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<tbody>
<tr>
<td><strong>First Tier – Individual Conduct Rules</strong></td>
<td></td>
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<tr>
<td>Rule 1: You must act with integrity</td>
<td>PRA &amp; FCA</td>
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<tr>
<td>Rule 2: You must act with due skill, care and diligence</td>
<td>PRA &amp; FCA</td>
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<tr>
<td>Rule 3: You must be open and cooperative with the FCA, the PRA and the other Regulators</td>
<td>PRA &amp; FCA</td>
</tr>
<tr>
<td>Rule 4: You must pay due regard to the interests of customers and treat them fairly</td>
<td>FCA only</td>
</tr>
<tr>
<td>Rule 5: You must observe proper standards of market conduct</td>
<td>FCA only</td>
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<tr>
<td><strong>Second tier – Senior Manager Conduct Rules</strong></td>
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<tr>
<td>SM1: You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively</td>
<td>PRA &amp; FCA</td>
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<tr>
<td>SM2: You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with relevant requirements and standards of the regulatory system</td>
<td>PRA &amp; FCA</td>
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<tr>
<td>SM3: 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</td>
<td>PRA &amp; FCA</td>
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<tr>
<td>SM4: You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.</td>
<td>PRA &amp; FCA</td>
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Draft Individual Conduct Rule 3 requires individuals to be open and cooperative with Regulators, including overseas regulators and exchanges as well as the FCA and PRA. Senior Manager Conduct Rule 4 (SM4) is also intended to extend to overseas regulators and exchanges. This is not new, but the rule creates some potential for conflict with the regulatory infrastructure chosen by other states.

General Counsel will wish to note that although as certified persons they will be subject to the Conduct Rules, including Individual Conduct Rule 3, they will not be subject to the express duty to disclose information to regulators under SM4. However, the proposed guidance at C-CON 4.1.10G, which suggests that the FCA will consider a person who took steps to influence a decision not to report to the regulator as having assumed responsibility for the decision to report, will be a matter of some concern to those advising in good faith on difficult calls about materiality and timing of reporting. Section 413 of FSMA should still protect communications between professional legal advisers and their clients from disclosure.

Individual Conduct Rule 4 on treating customers fairly is a new requirement for individuals. Whilst the concept of treating customers fairly may seem straightforward in theory, training will be needed to support individuals in exercising judgement in practice. It will need to cover individual cases and scenarios, and promote consistency between cases. The reasons for judgements made in individual cases will need to be captured. The rule also expressly covers non-regulated business.

Scope of application

The differing scope of application of the PRA and FCA Conduct Rules should have limited practical effect in determining the rules with which individuals must comply.

Nevertheless, the legislation and these proposals will effect a very significant policy change in the way that financial services regulation in the United Kingdom applies to individuals. The Conduct Rules and the regulatory disciplinary regime will cover employees who are not subject to any process of regulatory approval, or even firm certification – performing a job related to the provision of financial services within a relevant authorised person will be all that is required to bring the employee within the scope of regulation.

Individual Conduct Rules

The Individual Conduct Rules, including the two additional FCA rules, will be applicable to all individuals who are subject to the Conduct Rules, other than those persons based overseas who perform PRA-certification functions but not FCA-certification functions. Those who are certified by the PRA but not the FCA will be subject to the shared Individual Conduct Rules only.

Senior Manager Conduct Rules

The Senior Manager Conduct Rules will be applicable to individuals who perform an SMF specified by the PRA or FCA.

Scope of enforcement

The differing application of the Conduct Rules by each of the PRA and FCA means that the scope of enforcement powers available to the Regulators will be different, since they pursue different statutory objectives.

The Conduct Rules only apply to a person's conduct in relation to the activities which that person performs in their capacity as an employee or Senior Manager of the firm. The Conduct Rules do not apply to a person's behaviour in their private life if those behaviours are unrelated to activities they perform in their role for the firm. However, behaviour unrelated to those activities may still be relevant to the assessment of fitness and propriety.

Conduct Rules 1 to 3 and 5 should be within firms' existing training regimes. Senior Management Conduct Rules SMR 1 to 3 present greater challenges for firms and individuals in exhibiting responsibility for such overarching matters. There will be a difficult balance for Senior Managers in showing that they have taken reasonable steps to ensure that the business of the firm is controlled effectively, without harming the integrity of the three lines of defence and, for example, going so far as to direct the compliance or audit functions.

Collective vs. individual responsibility

The FCA's proposed guidance confirms that having overall responsibility for a matter does not mean having ultimate authority over it, and that the ultimate decision-making body of a firm remains its governing body, acting collectively.
Nevertheless, the FCA also suggests that where responsibilities are allocated on a shared or collective basis, each SMF would be jointly accountable for those responsibilities.

This approach has the potential to create some tensions, and to foster some potentially defensive behaviours which may impact the speed and efficiency of decision-making within financial institutions. It will be particularly important to maintain good documentary records of information provided to a Board, so as to evidence both challenge to, and the basis of, any decisions taken at board meetings.

**Key deliverables**

FSMA places three obligations on relevant firms, namely to:

- make individuals subject to the Conduct Rules aware that this is the case, and train them in how the rules apply to them;
- notify the Regulators when they are aware or suspect that a person has breached the Conduct Rules; and
- notify the Regulators when they have taken formal disciplinary action against an individual for any reason specified by the Regulator.
UK BRANCHES OF OVERSEAS FIRMS

Key Purpose

- Whilst UK branches of overseas firms are not currently included under the definition of "Relevant Authorised Person" (see Section 71A FSMA), the Chancellor announced in his 2014 Mansion House Speech that it was his intention to introduce an Order extending the regime to such non-UK institutions.

- Before publishing an Order, the Treasury must consult with the PRA and FCA. The proposed application of the regime to UK branches of overseas firms is subject to the outcome of that consultation, which is scheduled for later this year.

Scope of Application

PRA

With respect to the SMR, the PRA recognises that the primary responsibility for the management and governance of a UK branch of an EEA bank lies with its Home State Regulator. However, it proposes to require that one individual per incoming non-EEA branch be approved as an Overseas Branch Senior Executive Manager. This function will be defined as that of having "responsibility alone or jointly with others, for the conduct of all activities of the UK branch of an overseas firm which are subject to the UK regulatory system".

In addition, the list of SMFs includes the function of "Group Entity Senior Manager" (SMF7). This is defined as an individual, employed by a parent or other entity in the same group as the firm, who is deemed to exercise 'significant influence' over the firm's affairs. Such persons will also be required to be approved by the Regulators. This requirement may prompt a re-calibration of how firms choose to allocate authority and responsibility as between group entity managers and local branch management. There may be a trade-off between retaining high-quality, joined-up decision making at the group level, and a senior individual being willing to take on the additional personal responsibility of being regulated in the UK.

The PRA has confirmed to the Chancellor that it is not able to apply the regime to branches of banks that are incorporated in EEA member countries, as prudential supervision of such branches remains the responsibility of the home supervisory authority.

The PRA’s Certification Regime will also be extended to cover incoming branches of non-EEA deposit-takers and PRA-regulated investment firms. The criteria for material risk-takers (based on Commission Delegated Regulation (EU) No 604/2014) will be applied to persons acting in relation to such branches.

FCA

As conduct issues in relation to UK branches of EEA banks are not exclusively reserved to the Home State regulator, the FCA’s application of the regime to these branches is likely to be more complicated. The FCA will only be in a position to publish its proposals for consultation once it has had the opportunity to review a draft Order.

In relation to the Senior Managers Regime, the FCA will consider the extent to which it may be possible to adapt existing rules in the FCA handbook concerning Significant-Influence Functions. In relation to those individuals which fall within the Certification Regime, the FCA will consider adapting the current rules which apply to UK banks insofar as this is consistent with the Single Market Directives for EEA branches.
Many of the practical challenges and risks have been highlighted throughout this paper. We summarise some other key points to consider below.

**Senior Managers Regime**

**Statements of responsibilities**

There is some potential for ambiguity in the interpretation of 'significant change', and careful consideration will need to be given to this in the context both of regulatory notifications, and of keeping statements of responsibilities and responsibilities maps up to date.

By way of example, some structural changes within firms could result in a significant increase or decrease in the size of the business falling within a manager's area of responsibility which, whilst not involving any formal change of role or title, may nevertheless constitute a significant change. Equally, whilst taking on responsibility for a new project would generally be unlikely to constitute a significant change of responsibility, the magnitude and importance of a project to the business or the firm might in some circumstances represent a significant change of responsibility.

**Responsibilities map**

The firm's management body is required to approve the certificate, which places that body under scrutiny – notwithstanding the allocation of responsibility for performance by the firm of its obligations under the SMR to a Senior Manager.

The responsibilities map will be a central element of the firm's obligations, and systems and controls will need to be implemented to ensure both that the responsibilities map is designed accurately in the first instance, and that it is updated each time an individual changes responsibilities. If any enforcement action is to be taken against a Senior Manager, the FCA will use the individual's statement of responsibilities and the firm's responsibilities map to help inform them of the scope of the individual's duties, thereby placing greater emphasis on the importance of these documents to be accurate and up-to-date at all times.

Taken together, the SMFs, Prescribed Responsibilities and Key Functions are likely to require a new role description (or responsibility statement) for most Senior Managers at board and board –1 ('ExCo') level. These will require careful drafting to ensure that the scope is clear and the role is practicable and capable of being performed.

The Senior Manager Conduct Rules will also need to be borne in mind when crafting statements of responsibilities to ensure Senior Managers are given a fighting chance of fulfilling the responsibilities described. For example, SMR 1 states that senior managers must "take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively." The statement of responsibilities will need to articulate how that test is to be measured. In practice, Senior Managers are likely to make key decisions themselves and increase their monitoring of staff in a more detailed way in order to demonstrate these "reasonable steps".

**HR work streams**

In addition to the other HR-related points mentioned above, implementation of the SMR creates additional HR work streams. An audit will need to take place of Senior Managers' employment contracts and job descriptions (if any) as well as existing policies and procedures relating to appraisals, performance management, objective setting and determining fixed and variable remuneration to consider what changes may need to be made. New procedures will need to be put in place for the annual assessment of fitness and propriety. HR will play a key role in ensuring appropriate paperwork is in place regarding statements of responsibility and job descriptions (including keeping these updated), as well as the delegation of Prescribed Responsibilities and appropriate supervision. An ever closer working relationship between HR, legal and compliance will no doubt need to be fostered given the cross-over between these departments.
Orchestrated discussions will need to take place with the Senior Managers regarding who is taking on which Prescribed Responsibility – in many, but not all, cases this should be clear given their current roles. The detail of the statement of responsibilities will likely be discussed and agreed with the Senior Managers. Any resistance by Senior Managers to take on more responsibility will need to be addressed, job descriptions and roles amended accordingly. This process may include requests for legal advice and/or additional remuneration.

Looking forward, an area of particular focus from an employment perspective will arise when a Senior Manager leaves and is replaced by a new hire. The departing Senior Manager will be able to complete a handover certificate in the manner he sees fit without having to accommodate the bank’s views on presentation and content. A Senior Manager may be less likely to work with the bank on this certificate in the context of a contentious departure. Both the departing Senior Manager and the new hire will likely seek legal advice on their obligations given the potential personal liability. The new hire may wish to see the handover certificate before joining to understand fully what he is taking on as part of due diligence on the role. The content of the handover certificate may also trigger a discussion about additional remuneration where there are a number of issues to resolve. The new hire will likely also want to know what protection (if any) the bank can provide in the event of future regulatory challenge over the conduct of their Prescribed Responsibilities.

If a Senior Manager fails to meet any of the Prescribed Responsibilities (or the bank proposes removing a certification) then it will be vital to conduct an appropriate investigation and disciplinary process. The Senior Manager may well request legal representation at the hearing if the outcome of the disciplinary could ultimately impact whether they are a fit and proper person thereby impacting on their career – such a request would need to be carefully considered.

**Certification Regime**

**Identifying certified persons**

There will be a clear need to conduct a gap analysis and mapping exercise in order to identify which employees are caught by the new Certification Regime. This will need to factor in the overall picture of SMFs and prior controlled functions, since part of the test is by reference to whether an individual is an SMF or a controlled function holder. This analysis will also need to highlight and address circumstances where an individual holds a controlled function for another firm in the group which is not governed by the new regime.

Getting it right will also depend in part on whether the firm has correctly understood and implemented the CRR, from which the Regulators have imported the concept of ‘material risk taker’.

**Annual Renewals and amendments**

Monitoring systems and renewal processes will need to be brought in both as part of employees' annual reviews, and throughout the year as and when individuals attain new qualifications, change roles, or take on additional responsibilities.

Given that regulatory references will need to cover a 5 year employment history, including any disciplinaries (potentially even if unproven), comprehensive records will need to be kept even where no disciplinary action is taken. The content of such references is a potential area of dispute with a departing employee.

**Conduct Rules**

Training for relevant individuals must be carefully reviewed and updated to ensure it satisfies the obligations of the Conduct Rules: this includes ensuring that individuals fully understand the ambit of the rules and the consequences of the applicability of these rules to them and the consequences of non-compliance. This may require bespoke training for different groups of employees (e.g. customer-facing staff may require more training in Conduct Rule 4 (treating customers fairly) and traders more training in Conduct Rule 5 (market conduct)).

Firms will also need to ensure that they have fully explored and understand the scope and definition of these obligations to ensure that they are able to identify breaches and make appropriate notification to the Regulators following enforcement action.

Training should be designed to ensure that relevant individuals understand the relevant Conduct Rules and are able to identify and escalate possible breaches, and firms will need to implement relevant systems to effect notification.
Firms will need to develop and maintain record management systems to record training undertaken by individuals. Firms will need to review and update any current training to ensure it satisfies requirements set out in the Conduct Rules.

Additionally, firms should consider whether to review their policies to make any changes necessary to dovetail with the new Conduct Rules (i.e. requirements to undertake all relevant training and pass any assessments required as part of that training).
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