Proskauer

Senior Managers and Certification Regime - Extension to All FCA Authorised Firms is Coming

October 1, 2019

Introduction

On 9th December 2019, the Senior Managers and Certification Regime (SMCR) will replace the current Financial Conduct Authority (FCA) Approved Person Regime for practically all FCA authorised firms, including alternative investment fund managers (**AIFMs**), placement agents and investment advisers. SMCR will impose requirements and regulatory obligations (to varying degrees) on senior managers, individuals carrying on significant functions and general staff members working for authorised firms.

What is the SMCR?

The purpose of SMCR is to strengthen individual accountability in FCA authorised firms, imposing new requirements on firms and the way in which individuals working at such firms should conduct themselves. The FCA has stated that its aim is to reduce harm to consumers and strengthen market integrity by creating a system that enables firms and regulators to hold key personnel to account.

Which SMCR category does a firm fall within?

Under the SMCR, there are three categories that a firm can fall into, these categories impact the level or requirements that apply to that firm. These are:

1. ***Core firm:*** will be subject to the requirements of the "core" SMCR requirements, that is the senior managers' regime, the certification regime and the conduct rules;
2. ***Limited scope firm:*** a limited number of businesses, including some consumer credit firms, will fall into this category. This category has fewer rules than core or enhanced firms; and
3. ***Enhanced firm:*** extremely large businesses with more complex structures will fall within this category (in practice, it is expected that this will apply to less than 1% of FCA authorised firms).

The vast majority of firms, including full-scope and small AIFMs, will most likely fall within the "core firm" category. Firms will be permitted to "opt up" from limited scope to core regime or from core to enhanced regime, but will not be permitted to pick and choose the requirements that apply. If a firm chooses to opt-up, it will then need to comply with all relevant requirements of that category.

Furthermore, where a firm is part of a group which includes an "enhanced firm", the group can apply "enhanced firm" criteria to other group firms that would otherwise be in the "core firm" category.

The rest of this briefing focuses on the SMCR requirements applicable to a "core firm".

Differing SMCR requirements depending on an individual's role with a firm

The level of the SMCR requirements and obligations that apply to core firms and the individuals working for them will depend on their role and the associated SMCR categorisation they fall into. The relevant categories are:

1. Senior Managers;
2. Certified Staff;
3. Conduct Staff; and
4. Ancillary Staff.

A. Senior Managers

A Senior Manager under the SMCR is someone who carries on one or more "senior management functions" (**SMF**) for a firm. An SMF is any function carried on for a firm which requires the individual performing it to be: (a) responsible for managing one or more aspects of the firm's affairs which relate to its regulated business; and (b) those aspects involve, or might involve, a risk of serious consequences for the firm or for wider business or other interests in the United Kingdom (**UK**).

The following six different categories of SMF can apply to individuals working for a core firm; the corresponding controlled function under the current FCA Approved Person Regime is included for reference:

Current controlled function under the Approved Person Regime	Corresponding SMF (effective 9th December 2019)

CF1 – Director	SMF3 – Executive Director A director or of a firm other than a non-executive director.
CF2 – Non Executive Director	SMF9 – Chair The person with responsibility for chairing, and overseeing the performance of the role of, the governing body of the firm (this could be an executive or non-executive chair). Only a non-executive director who is the chair will carry out a SMF.
CF3 – Chief Executive	SMF1 – Chief Executive. The person (or persons) which responsibility, under the immediate authority of the firm's governing body for the conduct of the whole business.
CF4 – Partner	SMF27 – Partner A partner of a firm other than a limited partner in a partnership registered under the Limited Partnership Act 1907. A member of a limited liability partnership which is a senior manager would fall within this SMF.
CF10 – Compliance Oversight	SMF16 – Compliance Oversight The person responsible for the compliance function in the firm and reporting to the governing body on this function.
CF11 – Money Laundering Reporting Officer (MLRO)	SMF17 – MLRO The person who has responsibility for overseeing the firm's anti-money laundering systems and controls.

SMF16 and SMF17 are 'required functions', i.e. a core firm is required to have individual(s) appointed to carry out these two functions. The other SMFs only apply to a firm if they have individuals carrying out that function. For example, a firm which is a limited company would not have anyone carrying out the SMF27 (Partner) function. Likewise, if a firm does not have a Chair then no individual needs to be appointed as SMF9 (Chair) function.

It is possible for an individual to hold more than one SMF; this depends on their role within a firm. Equally, there is no territorial limitation on SMFs and it will apply to anyone who performs the role, whether they are based in the UK or overseas.

Prescribed Responsibilities

Prescribed Responsibilities ("PRs") are specific responsibilities that a firm allocates to Senior Managers.

For a core firm, there are four mandatory PRs that must be allocated to one or more Senior Managers, these are:

> **PR Ref (a)** - Performance by the firm of its obligations under the SMCR requirements as applicable to a firm's Senior Managers, including implementation and oversight
>
> **PR Ref (b)** - Performance by the firm of its obligations under the Certification requirements under the SMCR
>
> **PR Ref (b-1)** - Performance by the firm of its obligations in respect of notifications and training of the Conduct Rules under SMCR
>
> **PR Ref (d)** - Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime

There are two additional PRs (set out below) which are only required if they are relevant to a core firm's business:

> **PR Ref (z) -** Responsibility for the firm's compliance with FCA's Client Assets Sourcebook (CASS)
>
> **PR Ref (za) -** Responsibility for authorised fund manager's assessment of value, independent director representation and acting investors' best interests. This is only applicable to managers of authorised funds.

PR Ref (z) would be relevant if a firm holds client money or client assets and is subject to the requirements of CASS. PR Ref (za) will only be relevant to a very limited number of firms.

It is possible that one Senior Manager could be allocated to all four of the mandatory PRs.

Statements of Responsibility

Each Senior Manager at a firm will need to have a Statement of Responsibility (SoR). This will need to be a succinct, self-contained document setting out what the individual is responsible and accountable for within the firm. Only one SoR is needed for each Senior Manager even if that individual is carrying out more than one SMF. For those Senior Managers carrying out a PR, this should be referred to in their SoR.

Duty of Responsibility

Each Senior Manager will have a "duty of responsibility" to take reasonable steps to prevent, or stop, a breach of rules in their specified area of responsibility. If they fail to do so, the FCA could hold them responsible for the breach and take action against the individual.

FCA Approval of Senior Managers and Automatic Conversion for Current Approved Persons

Individuals that commence a SMF on or after 9th December 2019 will need to apply to the FCA for approval before commencing their role. Each application for approval will need to include the individual's SoR setting out the role and responsibilities of the Senior Manager.

As part of the transition to SMCR, Senior Managers currently approved to carry out a controlled function equivalent to an SMF will be automatically transferred over to this corresponding SMF (please refer to the table above). There will be no need for these individuals to apply for FCA approval assuming their role will stay the same at the time that SMCR comes into force on 9th December 2019.

Fitness and Propriety

Firms will be required to assess an individual's fitness and propriety to carry out a SMF; this includes taking into consideration the following factors:

- honesty, integrity and reputation;
- competence and capability, including whether the person satisfies any relevant FCA training and competence requirements; and
- financial soundness.

Criminal Record Checks

As part of its overall fitness and propriety assessment, a firm must carry out a criminal record check on the individual candidate. In order to do so, the firm will either need to register with the Disclosure and Barring Service, and the equivalent agencies in Scotland and Northern Ireland; or it could run the relevant checks through an umbrella organisation acting as an intermediary.

Regulatory References

For new hires from 9th December 2019, a firm must request a reference from the Senior Manager candidate's past employer(s) going back the last six years. These are known as regulatory references. This will also apply to non-executive directors who aren't Senior Managers.

B. Certification Staff

Broadly, the certification requirements under SMCR applies to those employees of the firm whose role is important enough to impact customers, markets or the business and potentially cause significant harm and involves them carrying on one or more of the FCA's Certification Functions.

Certification Functions

There are a number of Certification Functions under SMCR. The Certification Function likely to be most relevant to core firms is:

> **Client Dealing Function** – this is the most equivalent to the Customer Function (CF30) under the current Approved Person Regime. The Client Dealing Function would apply to any person dealing in or arranging investments with or for clients. It would normally include: financial advisers, individuals arranging deals in investments and investment managers.

If a Senior Manager is performing a Certification Function that is very different than what they are doing as Senior Manager then they would fall within the SMCR certification requirements. For example, a Senior Manager of a UK AIFM who also sits on the firm's investment committee would also fall within the SMCR certification requirements.

Regulatory References but no Criminal Record Check Requirements

For new hires carrying out one or more Certification Function from 9th December 2019, a firm must request a regulatory reference from the candidate's past employer(s) going back the last six years.

There is no requirement for a firm to carry out a criminal record check on an individual carrying out a Certification Function (assuming this individual was not also going to be a Senior Manager).

Fitness and Propriety

Firms will be required to assess an individual's fitness and propriety to carry out a Certification Function; this includes taking into consideration the following factors:

- honesty, integrity and reputation;
- competence and capability, including whether the person satisfies any relevant FCA training and competence requirements; and
- financial soundness.

Issuing Certificates

Although firms will need to have identified their Certification Staff by 9th December 2019, firms will have until 9th December 2020 before they need to have issued certificates stating that it is satisfied that a person is fit and proper to perform the relevant Certification Function as well as setting out those aspects of the firm's business in which the individual will be involved in.

C. Conduct Staff and Conduct Rules

Conduct Staff are individuals working for a firm which do not fall within the categories of Senior Managers, Certification Staff, or Ancillary Staff. These individuals will need to comply with the Conduct Rules (as explained further below).

D. Ancillary Staff

The FCA has provided the following list of roles and functions within a firm that it considers ancillary and which are therefore out of scope of the Conduct Rules:

- Receptionists
- Switchboard Operators
- Postroom Staff
- Reprographics/Printroom Staff
- Property/Facilities Management
- Events Management
- Security Guards
- Invoice Processing
- Audio-Visual Technicians
- Vending Machine Staff
- Medical Staff
- Archive Records Management
- Drivers
- Corporate Social Responsibility Staff
- Data Controllers and Processors under the Data Protection Act
- Cleaners
- Catering Staff
- Personal Assistants and Secretaries
- Information Technology Support (i.e., Helpdesk)
- Human Resources Administrators/Processors

Conduct Rules

The Conduct Rules are divided into two sub-categories: Individual Conduct Rules and Senior Manager Conduct Rules.

Individual Conduct Rules:

1. You must act with integrity
2. You must act with due care, skill and diligence
3. You must be open and cooperative with the FCA, the PRA and other regulators
4. You must pay due regard to the interests of customers and treat them fairly
5. You must observe proper standards of market conduct

Senior Manager Conduct Rules:

SC1. You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively

SC2. You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system

SC3. You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively

SC4. You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

The Individual Conduct Rules apply to all staff within a firm other than Ancillary Staff. The Senior Manager Conduct Rules apply only to the firm's Senior Managers.

Conduct Rule Training and Breach Reporting

Firms will need to train their staff to ensure they fully understand the Conduct Rules and how they apply to their particular roles. Firms will have until 9th December 2020 to ensure that all other staff (other than Senior Managers and Certified Staff who will immediately be subject to the Conduct Rules from 9th December 2019) have been trained and comply with the Conduct Rules on an ongoing basis.

Firms are required to notify the FCA when disciplinary action has been taken against a person for a Conduct Rule breach. In the case of a Senior Manager, this notification must be made within seven business days of concluding the disciplinary action against the individual. For Certification Staff or Conduct Staff the notification should be made as part of the firm's annual notification about Conduct Rule compliance (such a notification is required even if there haven't been any breaches).

Next steps

FCA authorised firms should be taking steps to ensure they are compliant with the SMCR from 9th December 2019. Among the questions that a firm should be considering as part of its preparations are:

- How is the firm categorised under SMCR, i.e. is it limited scope, core or enhanced?
- Do you know who will be a Senior Manager at the firm?
- Does the firm need to change any existing Approved Person approvals, or add new ones, ahead of conversion to SMCR?
- Does each of the firm's Senior Managers have an SoR?
- Have all of the PRs applicable to the firm been allocated to the relevant Senior Manager and clearly included in that person's SoR?

- Does the firm know which of the Certification Functions apply to the firm and which individuals carry out these Functions?
- Is the firm ready for the new criminal records checks and regulatory reference requirements? How do these fit into the firm's existing recruitment processes? Should the firm undertake a data privacy impact assessment? Does the firm need to update its privacy notices or records retention policy?
- Are the firm's current employment documentation and procedures sufficient to comply with SMCR?
- Can the firm identify all the firm's ancillary staff (i.e. those to whom the Conduct Rules do not apply)?
- Does the firm understand the Conduct Rules training and reporting requirements for Senior Managers and all other staff?

If you have any questions on SMCR and how best to comply with the new requirements, please contact us.

Related Professionals

- **John Verwey**
  Partner
- **Kelly M. McMullon**
  Special International Labor, Employment & Data Protection Counsel