

MEMO# 31891

August 7, 2019

FCA Publishes Findings of its Review of Implementation of the SM&CR by the Banking Sector

[31891]

August 7, 2019 TO: International Compliance Advisory Committee
International Internal Audit Advisory Committee RE: FCA Publishes Findings of its Review of Implementation of the SM&CR by the Banking Sector

Earlier this week, the Financial Conduct Authority (FCA) published a summary of its observations after reviewing 15 banking sector firms regarding their implementation of the Senior Managers and Certification Regime (SM&CR).^[1] The review, which involved interviewing 45 people at these 15 firms, was conducted “to better understand how the SM&CR has embedded in the banking sector in the 3 years since it was introduced” and determine whether any issues warranted additional attention by the FCA and the firms. The FCA’s review focused on five areas:

- Senior Manager Accountability
- Certification
- Regulatory References
- Conduct Rules
- Impact on Culture
- Unintended Consequences and
- Embedding and Overcoming Initial Implementation Issues.

Its observations in each of these areas are briefly summarized below.

Senior Manager Accountability

According to the summary, senior managers in all firms were clear on what accountability means in the context of their jobs and daily activities. Some expressed concerns with the blurring of the line between non-executives and executives that could occur if board members become more involved in the firm’s operations. According to the FCA, the SM&CR “does not seek to redefine the roles of non-executives.” Instead, the FCA it sees “the oversight role of non-executive directors and their ability to challenge management as a key safeguard for the interest of firms’ stakeholders.”

With respect to the SM&CR’s requirement to take “reasonable steps,” the FCA found some firms “were reluctant to state what they believe good looks like and inclined to look to the

regulators' expectations," which may indicate the need for further guidance from the FCA. The FCA noted that there is guidance in the Decision Procedure and Penalties manual that sets out some of the factors that the FCA would expect senior managers to be familiar with "to avoid a contravention from occurring or continuing." Because it would not be possible for the FCA to provide an exhaustive list of reasonable steps, it, instead, expects senior managers to "be doing what they reasonably can to prevent misconduct." It added, "[a]ppropriate controls and processes are an important part of this but we also look to senior managers to think more broadly and to create an environment where the risk of misconduct is minimized, for example through nurturing healthy cultures."

Certification

The FCA's review indicated that firms have implemented processes to oversee the certification population. While it found that firms "have broadened their approach to assessment of staff beyond solely technical skills . . . most firms could not demonstrate the effectiveness of their assessment approach, use of subjective judgement, or how they ensure consistency across the population." It also did not observe firms making any "significant change to their performance assessment processes other than incorporating expected behaviors."

Regulatory References

The FCA found all firms "positive" about the concept of using regulatory references to address the potential use of "rolling bad apples." Remaining challenges on this issue include improving the quality and timeliness of the references and firms being more consistent in recording breaches of the Conduct Rules. The FCA also noted that some firms were more likely to rely on references than others and often times this depended on the firm's size, risk appetite, and from where they recruit senior managers and certification staff.

Conduct Rules

This was the one area where the FCA expressed some concerns with firms' implementation of the SM&CR. The FCA found that:

- Firms have not always sufficiently tailored their conduct rules training to staff's job roles;
- There was insufficient evidence to be confident that firms have clearly mapped the conduct rules to their values, even though firms are often using their own values to articulate how they bring the conduct rules to life; and
- Firms were often unable to explain what a conduct breach looked like in the context of their business.

In response to these observations, the FCA reminded firms that the "conduct rules are a critical foundation for firms' culture and the conduct of individuals" and noted that it is "essential that staff understand the rules and how they apply to them." These requirements include: (1) notifying all relevant persons of the applicable conduct rules; (2) taking all reasonable steps to ensure such persons understand the rules and how they apply to such persons; and (3) providing suitable training.

Impact on Culture

On the issue of culture, most firms noted that they had embarked on changing their culture prior to the implementation of SM&CR. Many firms "described a stronger tone and ownership from the top" and all "talked about the work they had done to create a culture of

challenge, escalation and providing a safe environment for staff to speak up.” The challenge for firms, however, is finding appropriate ways to measure culture. Their effort to do so continues.

Unintended Consequences

While the FCA did not observe firms experiencing significant unintended consequences from implementing the SM&CR, some firms did experience a “culture of fear during the early days of the regime.” This apparently has largely dissipated due to firms: (1) working to develop an environment of healthy challenge and openness; and (2) seeing the regulators work collaboratively with them to achieve positive outcomes.

The FCA did observe processes and controls on approvals of new products and businesses being tightened, which has contributed to firms being more risk averse and considered around innovation initiatives. With respect to the SM&CR impact on staffing, the FCA noted that there was some evidence of recruitment challenges – particularly for candidates outside the financial services industry – but this was not universal. Most firms also mentioned the additional staff and work required to administer the regime, though some saw this “as part of creating a robust governance environment within their firms.”

Embedding and Overcoming Initial Implementation Issues

With respect to implementing the regime, the FCA noted that, while firms found the initial stages of implementation to be “challenging,” they “came to see clear definition of accountability as beneficial.”

It found that most firms are continuing to embed the SM&CR into their organization “particularly below the senior manager level, with a focus on the spirit of the regime and ensuring their approach is proportionate.” Some firms, however, “seem to have been less successful in embedding the regime below the senior manager level.” According to the FCA, there “is some room for further progress at the certification level and potentially more significant weaknesses in the implementation of the conduct rules for other staff.”



For its part, the FCA sees the SM&CR as helping establish a culture of accountability for conduct that aligns with the FCA’s “business priority to continue to work on firm culture and governance.” The FCA plans to increase its supervisory focus on the conduct rules and it expects all SM&CR firms to ensure that they are embedding the conduct rules into their business to be compliant with the regime.

Tamara K. Salmon
Associate General Counsel

endnotes

[1] See *Senior Managers and Certification Regime Banking Stocktake Report*, Financial Conduct Authority (5 August 2019), which is available at: <https://www.fca.org.uk/publications/multi-firm-reviews/senior-managers-and-certification-regime-banking-stocktake-report>.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.