



Senior Managers and Certification Regimes: Asset Managers

The FMR Advisory Round Table

FMR Advisory was established to help with the complexities of preparing for compliance with the new raft of Regulations that are hitting financial institutions. One aspect of this is providing a forum where industry practitioners can meet and discuss topics in a frank and open way. FMR Advisory took an active interest in the recent Fair and Effective Markets Review (FEMR), as well as the approaching Senior Managers and Certification Regimes (SM&CR), and when the Report was released in June, at the end of the Review, we immediately recognised this as an area of profound effect on the asset management community. The Report contains 21 recommendations and regarding individual accountability there is one in particular that drew our focus – the extension of the SMR into the wider non-banking financial market community. With this in mind, a Round Table was organised to discuss the extent to which the industry was already thinking about and planning for the impending regulatory approach. The above FMR Advisory Round Table was held on Tuesday 15th September under the Chatham House Rule, with invited representation from the asset manager and banking communities. This was to be a highly topical discussion that drilled down into a number of areas around how the industry might prepare for the SM&CR and where some of the challenges may lie. Given the early state of public discussion the attendees largely chose to remain anonymous and so any quotes have been anonymised accordingly.

Background

Recent years have seen a pattern of bad behaviour within the financial markets; whether looking at the LIBOR scandal, related IR benchmark fixings or the FX benchmark fixings. A number of firms have been involved in these scandals and the banks may well turn out not to have been the only culprits in the story. The Chancellor of the Exchequer, George Osborne, launched a joint initiative through the Bank of England, HM Treasury and the FCA, to investigate the Fixed Income, Commodities and Currency (FICC) markets with a view to reporting on areas for concern; together with suggested remediation steps. With a core focus on individual accountability, two planned outcomes were to reinforce confidence in the wholesale markets and to influence international regulation of trading practices.

During the course of a year, the consultation took input from banks, asset managers, brokers, infrastructure providers, national and international authorities and academics. Whilst the review was launched within the UK, the responses were often global in approach and perspective.

The FEMR work has been showcased around global regulatory bodies and the approach is already being studied by IOSCO and FSB, with a view to exploring ways of adopting similar measures across other jurisdictions.

Following the publication of the report, the FCA has already taken the recommendation of the report into account, in declaring that the approaching Senior Managers Regime, which was originally targeted at the banking community, would be extended to include non-banks such as asset managers and hedge funds as part of the SMR regulated community. Since the Round Table was held HMT have confirmed that Government will follow the policy recommendation made in the FEMR report and extend the SM&CR to cover all wholesale markets.

3 Strengthen regulation of FICC markets in the United Kingdom

- a. Extend the UK regulatory framework for benchmarks to cover seven additional major UK FICC benchmarks — accepted and implemented by HM Treasury on 1 April 2015;
- b. Create a new statutory civil and criminal market abuse regime for spot foreign exchange, drawing on, among other things, work on a global code (see recommendation 4a);
- c. Ensure proper market conduct is managed in FICC markets through monitoring compliance with all standards, formal and voluntary, under the Senior Managers and Certification Regimes;
- d. Extend elements of the Senior Managers and Certification Regimes to a wider range of regulated firms active in FICC markets; and
- e. Improve firms' and traders' awareness of the application of competition law to FICC markets.

The explanatory text in the Report clarifies:

33 The Senior Managers and Certification Regimes currently apply only to UK banks, building societies, credit unions and PRA-designated investment firms, leaving a significant group of regulated FICC market participants, such as inter-dealer brokers and asset managers, out of scope. Respondents expressed a range of views on the merits of extending the scope of these regimes. After careful consideration, the Review has concluded that there is a case for extending elements of them to a broader range of firms active in FICC markets, in order to establish common standards and provide a robust and consistent implementation framework

34 The elements to be extended would include: regulatory pre-approval and statements of responsibility for senior managers; certification of individuals with the potential to pose 'significant harm'; and enforceable Conduct Rules for individuals. The extension would also have the effect of substantially increasing the effectiveness of the mandatory regulatory references for firms outlined in recommendation 1c for staff moving between regulated buy-side and sell-side firms. The Review did not judge it proportionate to extend, beyond their existing scope, the additional provisions included in the Banking Reform Act which gave effect to a 'presumption of responsibility' (described further in Section 5.1.2).

The Senior Managers and Certification Regimes

The SM&CR is in fact a set of linked regulatory regimes, conveniently referred to under the single umbrella. They are due to go live in March 2016 for Banks (and Insurance Companies under the PRA), with a twelve-month implementation period as various elements of the plan unfold. Experience of the last eighteen months' preparation for SM&CR led a Head of Strategic Advisory to remark that, *"The twelve month implementation plan from March 2016 may seem like a long time, however ensuring that everything is covered and live with everyone correctly trained looks pretty challenging."*

The SM&CR itself requires that a firm identify the most senior roles in the firm, usually at board level, with possibly a small number of additions. Each role, or Senior Manager Function (SMF), will have a defined set of responsibilities – or Map – that rolls up to the SMF. In this way all parts of the business have a single accountable Manager at the highest level. The people filling the SMF positions must be approved by the FCA.

The Certification Regime requires that staff below the SMF function who could pose a significant risk to the firm, are certified by the firm to be 'fit and proper' - appropriately qualified to undertake their role. This is to be a programme organised by the firm itself and is an ongoing process that is confirmed at least annually. Each of these people will be identified within the Map of Responsibilities.

Each Firm will have a Code of Conduct to which all staff members must sign up and to which they will adhere, with the only exceptions being ancillary staff such as cleaners or chefs.

Finally a new and stronger reference procedure is to be established, where the references that are requested and given when a person leaves a firm are to reflect at least the regulatory reality of that person's time with the firm.

The Round Table

The Round Table participants enjoyed an active discussion around the SM&CR elements, the related regimes and looked at the existing plans for SM&CR implementation that have been in flight for some months now within the Banking and Insurance communities.

So what does this mean for Asset Managers? The review is aimed partly at the wider FICC market structure and is recommending actions to address the deficiencies that the report has highlighted. The aim is for a more robust and transparent mechanism where wholesale market participants are able to transact trades in a more predictable and robust environment. The aim is also for higher standards of behaviour that are managed from the front-line, with remuneration that recognises and is dependent on correct behaviour. It is recognised that elements of this are already addressed within the Dodd Frank Act, MiFID and MAD, however large gaps in approach and progress remain.

The scale of preparatory work

The group reflected on the sheer scale of work involved in preparing for the new set of regimes. Before delving into the intricacies of potential work however there was an active discussion around how the new SM&CR would phase with the existing Approved Persons Regime (APER). As one Head of Strategic Advisory explained, *"From March next year the FCA will be running a dual approach across two regimes."* A Senior Legal Counsel posed the situation whereby it might be possible that once the SM&CR applies to Asset Managers, some Senior Managers may be covered by both regimes simultaneously – depending on the areas of business for which they are responsible – with part of the business falling under APER while other parts fall under SM&CR. Another question was the extent to which the FCA might run the two regimes in parallel, or potentially phase out APER all together in favour of the SM&CR. The former idea of running both regimes in parallel would potentially increase the cost of the compliance burden that the asset management community has to manage significantly. It was suggested that if both regimes run in parallel, a size threshold might be applied to the asset manager firms to define which ones would fall under the new SM&CR. As one participant said, *"The threshold above which asset managers may be affected, if one exists, will be important to watch."* However the application falls out in the end, the additional cost burden related to measurement and phasing between the regimes caused some concern amongst the group. FEMR establishes an approach in saying in section 3d) *"HM Treasury should consult on legislation to extend elements of the Senior Managers and Certification Regimes to a wider range of regulated firms, covering at least those active in FICC wholesale markets."*

Running the SM&CR in parallel with APER

The discussion then moved into the area of Senior Manager Functions (SMF) and how this relates to the current APER definitions. The role of CF29 as a senior management function such as Head of Compliance was highlighted as possibly falling into a SMF role, whilst the client facing CF30 was suggested as falling within the certification regime and probably not being one of the SMF roles. One attendee explained how as a branch of a bank that is already in advanced stages of preparation for SM&CR in March next year, *"We are in the preparation stages and as a branch, we have limited the SMF numbers"*

accordingly; for instance we don't have a requirement to register a compliance officer, as opposed to the current regime as CF29. Under the current regime we have some 30 CF29's and under the new regime we will have 4 or 5 who are truly heads of business."

The FCA has acknowledged that the current APER roles do not all transfer directly over to the new SM&CR. The key difference is how the new SMF roles will be a limited number compared to the wider APER roles. The split is between the Senior Managers Functions and the Certification Regime. As one Senior Banker explained, *"We are looking to follow the FCA guidance and limit the number of people who become registered."*

Whilst the SMF roles will be a narrower set than in the APER and will be approved by the FCA, the Certification Regime, which is perhaps broader than the current APER, is to be managed directly by the firm rather than through an approval process managed by the FCA.

The Certification Regime

Under the Certification Regime the firm is responsible for assessing and 'certifying' the fitness and propriety of certain employees who perform 'significant harm functions'. This has a major marker at an annual assessment, but is expected to be an ongoing activity with appropriate training and continual development. A Senior member of a bank commented that, *"It is interesting to hear the view that the new regime might extend beyond the front office for the certification regime, as we have not made so far that assumption."* Given that in a recent briefing the FCA made it clear that they expected the Certification Regime to cover areas outside of only the front office, it is clear that even at this advanced stage there is a degree of interpretation in the implementation of the approaching SM&CR, which will take some time to find the levels of best practice.

Further discussion around the split between the two elements brought out the idea that the FCA is expecting a smaller set of SMF roles that will be held accountable. As a Senior Legal Counsel put it, *"Imagine a large board such as ours – the numbers of Senior Managers will mount up if everyone has to be under that regime."* While the map of responsibilities certainly allows for the delegation of responsibility to a staff member reporting to the SMF, it also requires that the accountability remain with the SMF. Further discussion talked around the possibility of being on the Board but not holding a SMF, even when not being a Non-Executive Director. In the end the feeling was that this might be possible in theory, although the feeling was that in reality, by virtue of being a senior director, the person would have to be a SMF. The assumption was that if it was in some way feasible to be on the board without being a SMF, the role would certainly fall under the Certification Regime.

Senior Manager accountability

This in turn led to a discussion around how a SMF can be accountable for an area of business where they may not have daily visibility of performance. Under the SM&CR implementation for Banking firms, the approach for application of sanction against a SMF for any wrongdoing has been likened to the reversal of the burden of proof, enshrined and established in UK Law for centuries. The FCA has sought to refute that as an approach, although this remains a topic of heated discussion amongst senior managers and any FCA action in this space following implementation will be closely followed. The FCA clarified their approach in March 2015 when they stated, *"Under the*

Presumption of Responsibility, when a relevant/authorised firm contravenes a relevant requirement then the Senior Manager with responsibility for the management of any of the firm's activities in relation to which the contravention occurred is guilty of misconduct, unless they satisfy the relevant regulator that they took such steps as a person in their position could reasonably be expected to take to avoid the contravention occurring (or continuing). The proposed guidance sets out the circumstances in which the FCA would seek to apply the presumption of responsibility; how the FCA would apply it and the steps that a Senior Manager should take in order to rebut the presumption of responsibility." The group was relieved to hear that it is not proposed to extend this approach into the non-banking firms, although the ultimate accountability remains.

A firm-wide Code of Conduct

The firm-wide Code of Conduct that will be required was not in itself felt to be an issue, not least as it was felt that all firms have an established code already in existence and as one participant put it, *"The code of conduct looks like it mirrors the principles for APER which currently apply to the firm."* However it was acknowledged that some codes may require updating in the light of recent scandals. Another participant confirmed, *"Many firms already have their own set of principles – a code if you will – that applies to all employees. It is not too dissimilar to this new code of conduct."* So while firms already will operate some kind of internal code, the core difference will be in the implementation and confirmation around the new Code of Conduct.

The HR and compliance challenge – more training

Looking to the practical implementation efforts needed to establish the training that will be required to support the Certification and Code of Conduct work, the group saw a significant challenge to HR and Compliance areas. The current approach was summarised as blanket in nature across a range of roles, without a necessarily specific application to sub-roles. For instance the role of 'money market trader' might be supplied with a range of training for Anti-Money Laundering, Know Your Customer or professional skills based improvement; but this would seldom be down to the individual sub-asset class level of say 'Government Bond trader' as opposed to 'Corporate Bond trader'. The group discussed the range of scandals that have engulfed the financial markets in recent years and how many firms are already well into a range of activity to ensure a positive ethos is part of how their firm operates. One Director said, *"To truly change the ethos of how a company works is a longer-term challenge. It has to be lived by all from the top to the middle to the bottom."*

One senior participant raised the question as to what would happen if a staff member willfully breaks the code of conduct and what the legal position would be. The consensus was that breaking the code might not be a criminal offence and would not fall directly under the FCA, as the staff member would not be approved directly by the FCA. However it would of course be a disciplinary offence within the firm. Of concern to the group was that the Senior Manager who is ultimately accountable for that area of the business would be held to account for that staff member's actions, should they have a negative outcome. As one Director put it *"The difference in the new code of conduct is not necessarily the code itself and is probably more to do with the implementation and follow up. The Senior Manager is now individually responsible for this being followed."*

With an eye on the litigious nature of the financial markets in current times it was felt that a firm would need to demonstrate a far wider and deeper level of training than is currently offered – and that the measurement of this training and learning would also need to be demonstrable. The Code of Conduct training was called out in particular with the idea that sending an annual email to all staff asking for an acknowledgement of compliance to the code, would no longer suffice. Indeed the effects would be felt in the wider areas of HR as one participant put forward the view that. *“In the past one would see a standard set of job descriptions across a range of general trading or sales roles. Now each role has to be individually tailored. This also has a huge effect on training for say market abuse, conduct or risk control. The overhead now is significantly higher and more complicated.”* More detailed training with regular testing and acknowledgement was felt to be necessary, not least to afford some element of protection for the Senior Manager in circumstances such as those outlined above.

A new reference procedure

The final area of the new set of regimes to be discussed was the new approach to references that are given when a staff member moves to another firm. The FCA is calling for an end to the currently anodyne methods of providing references, from which an employing firm can learn little. As a minimum the new references will need to contain any compliance infractions that the employee may have made. The group made a point that the wider laws are not changing in any way and there may be some interesting times ahead for HR departments as they balance between the new stronger reference content and the possibility of litigation from a disgruntled former employee. One senior participant summed this up with, *“The new reference regime is going to be a minefield for the HR department.”*

So is this going to become real?

The conversation moved to the likelihood of the policy recommendation being made real. Whilst the proposal is currently only that – a recommended policy change – it was felt that the political will behind the FEMR and the fact that it was established specifically to make these recommendations, would mean that most, if not all recommendations, would find some kind of life in due course. As one CEO of a large Asset Management firm put it when considering the potential workload, *“We have started the preparation already and are currently working through the definition of the responsibility map.”*

Summary

It was clear from the discussion around the table that there is a great deal of interest building in this topic and that the asset management world should have at least one eye on any policy development. The preparation workload on banks and insurance companies to prepare for SM&CR in March 2016 has been significant and has seen a large amount of resource applied to this – whether identifying and having the incumbent Senior Managers approved by the FCA in role, building the map of responsibilities or starting to build the certification regime.

FMR Advisory was asked to set up a follow-up meeting on the hypothesis that the asset manager industry should form a working group where members could share information and ideas around best practice as they make preparations for any SM&CR extension into the wider wholesale markets. The first meeting is being set up for mid-November and a number of firms have already indicated their support for this initiative and their intention to attend. The inaugural meeting will allow the group to define terms of reference, working rhythm and relevant governance.

Update

Since the Round Table was held, HMT have confirmed that they will be adopting the policy recommendation made in the FEMR report and the legislative process has already commenced that will bring this into effect. They have further confirmed that the reversal of the burden of proof has been altered so that the Senior Managers in all types of firm will have a 'duty of responsibility', as opposed to the original more draconian measure. They have also set out that this set of regimes will replace the 'discredited' APER.

The reasons for ensuring a robust management of preparation for SM&CR are clear: ***“Senior managers will be held individually accountable if the areas they are responsible for fail to meet our requirements. Our new accountability regime will hold all senior managers, including non-executive directors, to a clear standard of behaviour and we will take action where they fail to meet this.”*** - Andrew Bailey, Deputy Governor, Prudential Regulation, Bank of England and CEO of the PRA.

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