The Senior Managers Regime and its Implications for the banking industry

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The Senior Managers Regime and its Implications

Why is this important?

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Why is the new regime necessary?

- PCBS Report "Banking for Good"
- Underlying principles:
  - Cultural change
  - Change in the way individuals working at banks are assessed and held accountable for the roles they perform
  - "responsibility that is too thinly diffused can be too readily disowned"
  - "too many bankers, especially at the most senior level, have operated in an environment with insufficient personal responsibility"
  - Clear intent "to make individual responsibility in banking a reality"
- Forward looking and judgment-based approach

The new regime: the changes

- There are three tiers to the new Regime:
  - Senior Manager's Regime: Came into force 7 March 2016 for banks. Note it was announced in October 2015 that the SMR regime will be extended to all FSMA authorised firms (including investment firms and asset managers). Becomes effective in 2018
  - Certification Regime: Transitional period for banks to complete certification process ends 7 March 2017
  - Conduct Rules: 7 March 2016 (Senior Managers and those covered by the Certification Regime) from 7 March 2017 for others
- New criminal offence of reckless misconduct that causes a financial institution to fail

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Financial Times: 8 October 2014

City disquiet at tough new rules sparks HSBC board departures

Regulator's regime threatening reckless bankers with jail is stricter than any in US or Europe

MARTIN ARNOLD, SAM FLEMING AND ALISTAIR GRAY

Two board members at HSBC's UK unit are preparing to quit as part of a growing pushback against stiff new rules that would jail reckless bankers.

The move underlines the disquiet in the City over the tougher stance taken by British regulators since the financial crisis. Some senior financial executives are warning that more directors could quit over the new regime, which is much tougher than rules in the US or Europe.

Alan Thomson, who sits on the audit and risk committees of HSBC Bank plc, has resigned and will leave the board of the lender's UK subsidiary in January.

John Trueman, its deputy chairman, is also preparing to resign. Renato Fassbinder, who quit last month after only a year as chairman of the audit committee on HSBC's main board of directors, also left because he was upset at the general direction that regulation was taking, people close to the company said.

The moves come two months after regulators revealed proposals for a new regime to stamp out misconduct in the City, which followed the Libor rate-rigging scandal and the collapse of Royal Bank of Scotland and HBOS.

Andrew Tyrie, the MP who chairs the Treasury committee and is a driving force behind the new regime, said: "The crisis showed that there must be much greater individual responsibility in banking. A buck that does not stop with an individual often stops nowhere."

But one senior UK banker said: "This is an industry concern. A lot of people are saying they won't join bank boards or won't stay on them."

The new rules include giving "senior managers" a clear definition of responsibility and making them accountable for any misconduct in that area, as well as introducing a criminal offence of reckless misconduct that causes a financial institution to fail. There is no equivalent offence elsewhere. Regulators are also planning the world's toughest regime for clawing back bonuses up to seven years after they are awarded.

One senior lawyer said: "We are seeing existing non-executives who are looking at their position and saying, 'Am I up for this?'"

"They are worried about personal liability and where the regulator may want to take things in the future," said another lawyer. "You don't want the good people being scared away."

Directors 'are looking at their position and saying, Am I up for this?'

Senior lawyer

In his resignation letter, Mr Thomson cited the forthcoming conduct regime and his other commitments as reasons for his departure, which was first reported by Sky News. HSBC and its UK directors declined to comment. Mr Fassbinder, the former Credit Suisse finance director and vice-chairman of SwissRe, could not be reached for comment.

The "Volcker rule" in the US requires chief executives to attest annually that their banks are in compliance with the proprietary trading ban.

Additional reporting by Tom Braithwaite in New York

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Who is affected by the new Regime?

- Senior Managers – c-suite members
- Material Risk Takers
- Those previously performing Significant Influence Functions under APER and approved persons
- Customer-facing roles subject to qualification requirements
- SIDs but excludes "notified NEDS"
- Excludes: receptionists, switchboard operators, post-room staff, reprographics staff, facilities management, events management, security guards, invoice processing staff, archive records management, data controllers or processors, cleaners, catering staff, secretaries, information technology support (help desk), HR administrators

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Main objectives of the Regime

- Greater clarity of overall and individual responsibility
- Improved corporate governance requires Senior Managers to be accountable between them for every aspect of regulated activity – strong emphasis on documenting responsibility and evidence in compliance
- 30 different prescribed responsibilities designated by the FCA and/or PRA to be allocated to those performing Senior Management functions

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Who will be a Senior Manager?

- Drawn from top levels of management and decision makers
- Decision makers overseas?
- Must be approved by the regulators (unlike Certified Regime Persons)
- Management responsibilities map
- Reversal of the burden of proof – “presumption of responsibility” – now scrapped
- Clear structures of accountability and delegation of responsibilities

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The Certification Regime

- Onus passes from the Regulators to the bank to certify that employees falling within the scope of the Certification Regime are ‘fit and proper’
- Regulators require Senior Managers to assume responsibility for the internal assessment and certification process
- Certification must take place annually: certificates are valid for 12 months
- Note: the class of persons captured by the Certification Regime is far broader than those currently performing SIFs under APER

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New Conduct Rules

- C-CON bear a striking resemblance to existing APER Principles but two key areas in which there are material differences: scope and accountability
- "if relevant firms are to achieve cultural change there needs to be a common understanding of what is acceptable and unacceptable behaviour at all levels of the firm"
- Requirement to evidence that "reasonable steps" were taken to prevent the regulatory breach

New Conduct Rules

First tier – Individual Conduct Rules	
Rule 1:	You must act with integrity.
Rule 2:	You must act with due skill, care and diligence.
Rule 3:	You must be open and cooperative with the FCA, the PRA and other regulators.
Rule 4:	You must pay due regard to the interests of customers and treat them fairly.
Rule 5:	You must observe proper standards of market conduct.
Second tier – Senior Manager Conduct Rules	
SM1:	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
SM2:	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.
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.
SM4:	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

Evidencing Compliance

- "This new statutory requirement will place an evidential burden on those Senior Managers who, by virtue of their rank and seniority, should have the knowledge and authority to prevent or tackle regulatory failure" (Consultation Paper)
- Under the new regime, self certification will not be considered as adequate evidence of compliance. Compliance under the Certification Regime must be evidenced
- The three Cs:
  - Clarify
  - Communicate
  - Confirm

Enforcement/Penalties

- The FCA's focus will be "increasingly on those in Senior Management that fail to recognise and manage their firm's risks, that fail to control the way that products are sold and that fail to ensure the customers' interests are prioritised when designing products"
- "Enforcement will be more forward-looking…better informed…with a greater appetite to get things done"
- The PRA believes its early intervention approach should make enforcement rare but if enforcement is necessary it possesses a full set of disciplinary powers
- Enforcement is largely the domain of the FCA
- Policy of credible deterrents: approach of early intervention

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Enforcement Powers

- The aim is to raise standards of behaviour in firms and especially amongst Senior Managers, by making clear there are "real and meaningful consequences for practice". (Consultation Paper)
  - Private warning
  - Restrictions on business that can be undertaken
  - Withdraw authorisation (firms)
  - Fines (firms/individuals)
  - Public censure
  - Suspension (individuals)
  - Prohibition (individuals)
  - Prosecution (individuals)
- New offence of reckless misconduct

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