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SM&CR FOR FINANCIAL SERVICES

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MINI-ROUNDTABLE

SM&CR FOR FINANCIAL SERVICES

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Julie Pardy has been working within the financial services sector since 1988. She is currently the Director of Regulation and Market Engagement for Worksmart Ltd. Within this role Ms Pardy is responsible for leading the business on regulatory matters, interpreting regulatory requirements, then working with the product teams to develop software solutions to help businesses manage their regulatory requirements around people and processes. This encompasses areas such as training & competence, knowledge & competence, complaints management, quality assurance and latterly the Senior Managers & Certification Regime. Ms Pardy has spent the last three years focusing in on helping firms implement SM&CR.

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Nic Dent has worked within financial services for most of his career, with the last 15 years spent advising on IT-based business solutions within the UK financial services sector. For the last three years, Mr Dent has channelled his expertise into SM&CR. His understanding of the challenges experienced by a whole variety of firms means he has been a key contributor to Worksmart's SM&CR proposition.

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Angela James has worked within financial services for over 30 years. For the last 10 years, she has supported the design and implementation of software solutions for training and competence, quality assurance and complaints management processes. Since 2015, Ms James has led the design of Worksmart's SM&CR banking solution and has used that experience to the design of Worksmart's SM&CR solution for the wider market.

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After a career managing organisational change, **Peter Griffiths** joined Worksmart in 2005. Since then, he has focused on helping customers implement the Worksmart software and optimise its use. Mr Griffiths has led all of Worksmart's SM&CR implementations in UK banking. Using this experience, he has been a key contributor to the design of Worksmart's latest SM&CR solution.

R&C: Could you provide an overview of the Senior Managers and Certification Regime (SM&CR)? What are its core components?

Pardy: There are three key elements to the SM&CR regime. First, the Senior Managers Regime (SMR) will replace the Approved Persons Regime (APR). Its roots come from the Parliamentary Commission for Banking Standards review published in 2013. The review recommended to Parliament that a new regime was introduced into financial services, with greater levels of transparency, ownership and individual accountability. The second element of this regime sees firms required to implement an internal Certification Regime (CR) for certain types of staff members. The CR is intended to ensure that regulated firms assess and 'certify' key staff on an annual basis as fit for purpose to continue to carry out their role. The CR will apply to those that fall into predefined 'significant harm functions' and will encompass annual assessment in the areas of Fitness & Propriety, Honesty & Integrity and Competence & Capability. Third, the new SM&CR regime introduces the concept of Tier 1 & Tier 2 Conduct Rules to the majority of staff across all financial services businesses. This means that the Financial Conduct Authority (FCA) can now take action against any individual covered by the Conduct Rules in a regulated business. In addition, firms will need to report any Conduct Rules breaches to the FCA on an annual basis. This requirement comes in addition to having to report Conduct Rules breaches to the Prudential Regulation Authority (PRA) or FCA within seven working days for those in the SMR.

James: From a systems and record keeping viewpoint, the new rules place a significant responsibility on firms to create and maintain records. From a Senior Management Regime (SMR) perspective, the key records to maintain activities are the tracking of Senior Manager Functions (SMFs), Prescribed Responsibilities – including Delegated Responsibilities – Key Function assignments and the ability to easily be alerted to gaps in the governance structure. Systems should also facilitate the handover process from one senior manager to another, making the process seamless when new assignments are made. The Certification process should also include records that take a holistic view of an individual's competence in role. Typically, this would include undertaking Fitness & Propriety checks, assessment of competence against each Significant Harm Function (SHF) that the individual holds and last but not least, any Conduct Rules Breaches recorded against an individual in the last 12 months. The process should allow the individual to complete their activities in a simple and timely manner and for the overseer to have all the relevant information at their fingertips to complete the issuance, recording and distribution of Certificates in a time-effective manner. A system should also support the creation of Regulatory References – the new rules require six years of references for all staff in the SMR CRs and the monitoring of who and when references were issued – so enabling updates should significant information come to light. Finally, a system should support the capture of supporting documentation as evidence of Reasonable Steps within their role. Reasonable Steps is a requirement of senior managers to demonstrate they are acting responsibly and behaving in a way that is consistent with the Conduct Rules to which they have signed up.

Dent: Firms should think hard about the suitability and relevance of existing processes, especially with regard to consistency of approach, transparency, future-proofing and reliability in the long term. The scope of the new regime makes demands on what might currently be disconnected departments and siloed processes. Firms should consider the challenges placed on the HR, compliance, risk and legal functions to work harmoniously to ensure compliance with the new rules. I would also highlight the importance and challenge of maintaining a full and complete historic record that is easy to access and interrogate. This is a key point as this was one of the most significant learnings from the banking sector in this regard, where two years in, organisations found themselves concerned about the accuracy and transparency of their SM&CR records. It is also worth mentioning the learning curve and where we have seen many colleagues struggle with understanding the considerations of other departments as they get to grips with new terminology. For example, this may be the first time that some staff in HR teams will have needed to understand the world of compliance and vice-versa, for instance. In our experience, this takes time to come together.

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Nic Dent, Worksmart

Griffiths: From an implementation point of view, firms should appreciate that there are three key areas, such as SMR, CR and Conduct Rules, where they will not only have to undertake activities in order to comply, but they will also need to evidence compliance. From experience, organisations seldom appreciate the weight of process, oversight and recordkeeping needed in order to evidence competence for individuals in different roles within Certification. My advice would always be, when you scope the time you think is needed to implement all elements of the new regime, double it and then add some more resource and budget in, because from experience, you will need it.

R&C: What do you believe are the key challenges for Solo Regulated Firms when implementing SM&CR?

Pardy: There are many implications for firms, probably too many to cover here, but a few highlights are worth noting. The first is that understanding the implications of the new regime sounds easy – just read the Consultation and Policy statements issued by the FCA and then implement what is required. But of course, anyone involved in financial services regulation knows it is never that simple. One of the biggest challenges we have seen many solo and dual regulated firms battle with is being able to translate what you read into actionable business tasks. Many firms have found it helpful to turn to their trade or professional bodies to make use of resources they have made available, such as webinars or breakfast briefings, and we would support that. The second highlight is considering the impact on employees and business processes. This is not one that can be answered in a short paragraph, but suffice to say that contracts of employment, job descriptions and business processes from induction to dismissal will need a review, and in many cases rewriting to include all the relevant changes that each element of the SM&CR regime brings. The third highlight is implementing SM&CR versus managing it once implemented. Most organisations focused the majority of their project resource on a 'big bang' – getting the regulatory paperwork completed and submitted, and hitting the regulatory deadline. Resource tended to fall away and was diverted to other projects once 'go live' was achieved, with limited thought and resource given to the fact that the weight of the SM&CR regime actually sits in the CR, and this demands regular and intensive assessment of competence and capability of those affected.

James: The key challenges for all firms include a robust recordkeeping system and the ability to retrieve and report on the state of the business at any point in time. For the SMR element of the regime, this should cover organisational structure, SMF Function Holders, Prescribed Responsibility assignments, accurate and up-to-date Statements of Responsibility and the Committee Governance Structure that supports the executive board. For the CR, the biggest challenge for firms is the bringing together of all competence evidence in order that an appropriate assessment can be undertaken by those making the competence decision. To support both the Senior Management and Certification regimes, there are also a number of regular activities which need to be undertaken, including Fitness & Propriety background checks and the recording of training records. Overseers and those responsible for each of the regimes need to be confident that these are being completed in an accurate, consistent and timely manner, and any issues arising are quickly and efficiently addressed.

Dent: Demonstrating a consistency of approach for all authorisations, validations and approvals is certainly challenging. Firms may need to consider the impact of this on the roles and duties of colleagues and the importance of robust, transparent, reliable and coherent processes. Those firms that we have seen manage things most effectively and comfortably have succeeded in devolving ownership of the processes down through the organisation, but without losing oversight or control.

Griffiths: Based on experience, the key challenges came in three main areas. First, while understanding and allocating SMFs among the executive team was, for the most part, straightforward, deciding whether certain other SMFs were relevant, such as SMF18 Overall Other Responsibility, took some firms a great deal of time to decide. Similarly, deciding which Prescribed Responsibilities were relevant to the firm, and whether the suggested definitions should be adjusted, was another challenge. Second, while deciding which SMFs and Prescribed Responsibilities were relevant to each member of the executive team is one thing, gaining their agreement was another thing entirely; in some cases, gaining formal agreement took months to secure. This was due, in large part, to the reluctance of some executives to formally accept such significant amounts of personal accountability. The third, and final, area of challenge was far more practical. It was simply that some banks simply misunderstood the size of the implementation task, and so under-resourced the SM&CR project. Inevitably, this led to uncertainties and delays in the project and, ultimately, risking being ready in time.

R&C: In what ways is SM&CR likely to impact the business models and governance structures of financial services firms?

Pardy: We have seen firms affected in a number of ways. Firstly, there have been businesses which have changed their governance structures to move people 'out' of the new regime. Examples of this are executives that might sit overseas in a group or parent company, who are involved within the UK business but may not want to be regulated by either the PRA or FCA. Secondly, we have seen a real positive approach to a firm's assessment of the effectiveness of its governance arrangements.

Using the FCA's concept of Key Functions, and Key Functions Mapping among the executive team and to those that have Overall Responsibility for a key function has seen firms highlight gaps in their governance structures that might not have been seen if the exercise had not been carried out. Finally, we have seen the regime do exactly what I believe was intended, and many individuals have stepped down from holding pre-approved regulatory roles as they were not prepared to accept individual accountability.

James: If an organisation implements a system to support its adherence to the regimes, the best modelling and recordkeeping solutions can provide some level of transparency through the firm's structure for all users, allowing them to see who is ultimately responsible for the various aspects of the firm. This has the potential to improve communications and business strategy throughout the organisation from the top down and bottom up if applied well. Making a technology solution a 'must have' corporate governance tool at the same time as being a wider SM&CR solution ensures that users obtain business benefit as well as regulatory compliance.

Dent: When asked to manage and retain a comprehensive and detailed record, many of the banks were caught out by just how dynamic and changeable their governance structure is, in terms of executives leaving, new executives being recruited and executives changing roles or responsibilities within their existing role. Consequently, firms should consider whether they have adequate systems and processes to manage that. In parallel, we have certainly seen an extra emphasis on policy, risk and quality management too, with firms enhancing and developing more robust and transparent processes, including the need to unlock channels of communication down through the organisation.

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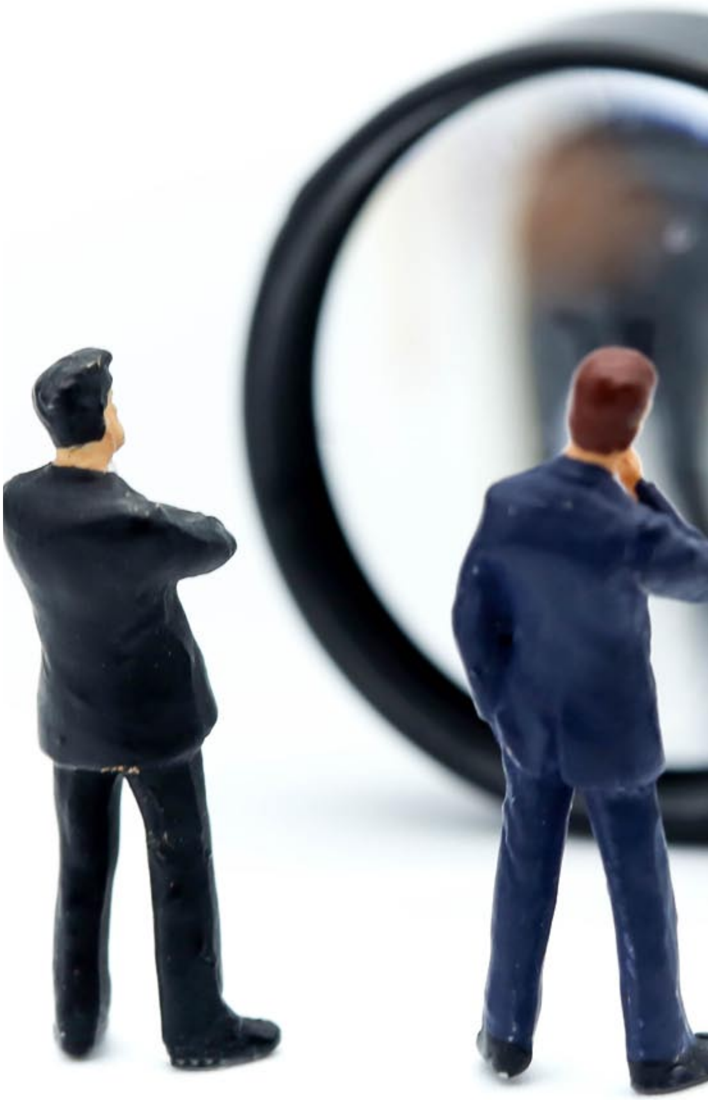
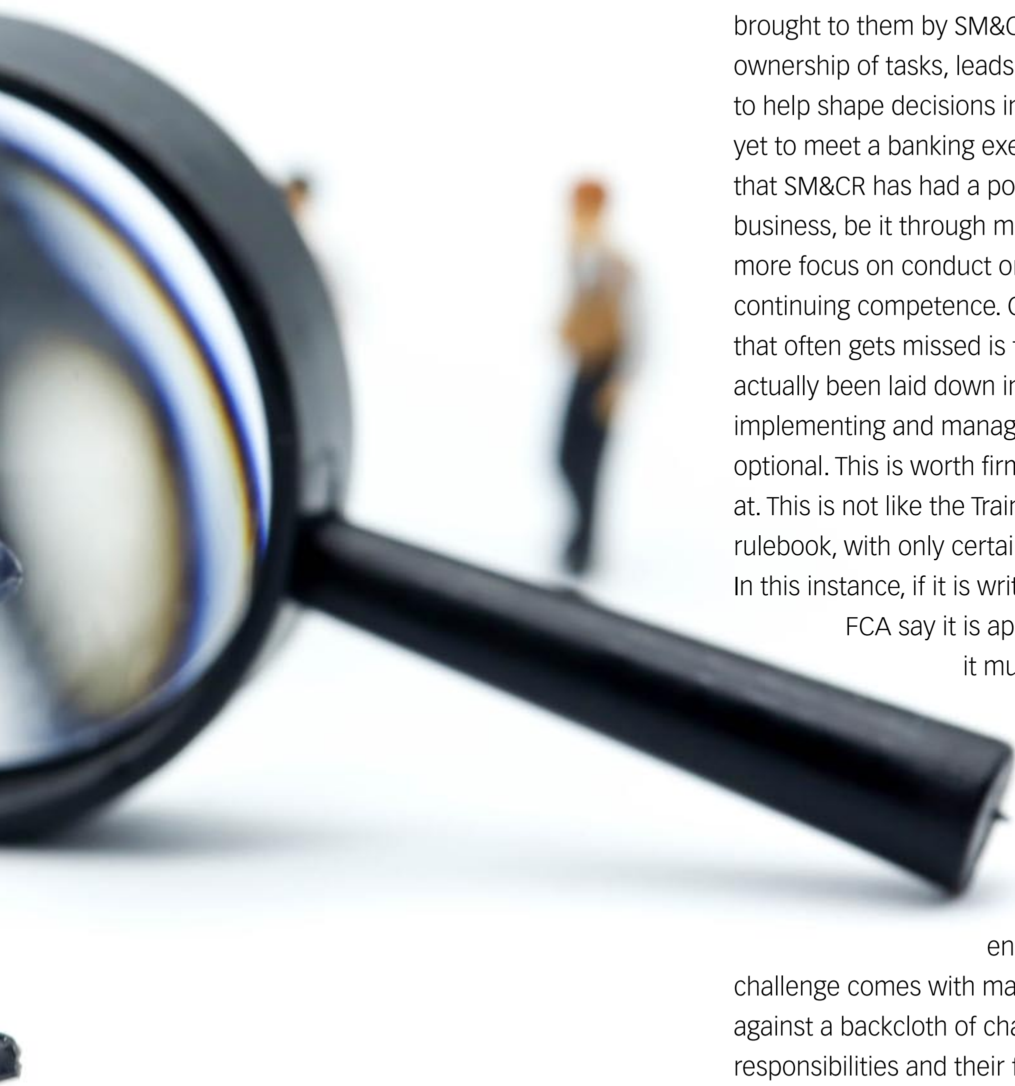
> *Angela James, Worksmart*

Griffiths: The new rules sometimes required the executive team at a bank to reconsider the robustness of their committees, such as their structures, terms of reference and memberships. Also, on occasion, they had to consider the quality of the management information available to the executive team to monitor the governance of the firm. Secondly, and what came as a major surprise, was the amount of time and effort it took to get non-executive directors (NEDs) 'on board'. For such a small number of people, NEDs invariably took a disproportionate amount of the implementation team's time. There were several reasons behind this, for example being part time meant 'access' challenges, NEDs often working across industries meant it could not be assumed they understood the context and intent of the new rules, some NEDs being based overseas sometimes meant cultural challenges, and so on. While not all NEDs were a challenge, it was important to ensure NEDs received the support they needed to get 'on board' with the new rules and their new responsibilities.

R&C: To what extent might SM&CR help to drive positive cultural change among financial institutions, reshaping how their senior managers conduct their business?

Pardy: SM&CR will allow firms to have clear lines of responsibility and accountability that should change the way individuals approach their responsibilities within a business. For example, if a senior manager is personally accountable to the FCA for ensuring that the newly introduced CR is run efficiently and effectively, and they have to attest to this fact, I suspect that this will focus the mind





in ensuring that a really robust process is in place. Some are using the clear lines of accountability brought to them by SM&CR to help them decide on ownership of tasks, leads on project ownership and to help shape decisions in the boardroom. I have yet to meet a banking executive that cannot tell me that SM&CR has had a positive influence on their business, be it through more effective governance, more focus on conduct or more input around continuing competence. On a final note, something that often gets missed is that this new regulation has actually been laid down in legislation. So, for example implementing and managing an internal CR is not optional. This is worth firms taking a good long look at. This is not like the Training & Competence (T&C) rulebook, with only certain firms having to adhere. In this instance, if it is written into legislation and the FCA say it is applicable to your firm, then it must be implemented and managed effectively.

James: The initial setup of the Senior Management structure may be challenging enough, but the real challenge comes with maintaining adequate records against a backcloth of change – to personnel, their responsibilities and their functions. One way to approach the SMR is to 'model up' responsibilities to individuals and to associate the responsibilities and key functions with committees. This ensures that each committee has the appropriate senior manager, who holds the responsibility or key function relevant to that committee, as a member. This easily highlights gaps in a firm's governance arrangements. With the CR, SHFs can be mapped to job roles, so that when an individual is assigned a new job role, the system will prompt for assessment and Certification if the SHFs have changed because of the change in role. To determine who should be within the Certification Regime, the 'best practice' approach is to review each role and its job description – which should also be stored with an individual's record – against a decision point that determines where the role requires qualifications. Using a system solution gives peace of mind that appropriate actions are undertaken as and when changes are applied to the business structure.

Dent: While the feedback that we have received from senior managers within banking has been broadly positive in what they see as the spirit of the regime, its impact on the industry and its reputation as a whole, there is a more mixed feeling about the benefit for individual firms. However, the impact of obtaining clarity on a firm's governance arrangements, being clear on the chain of command and exactly who is responsible for what is usually regarded as a good thing within organisations. Nevertheless, we do still spend a lot of time talking to firms about the ongoing difficulties of managing conduct and competence in an effective way. Insights into behaviours and capability is obviously key, but alongside access to meaningful information, firms need to consider the practical and operational challenges of intervention and oversight.

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> *Worksmart*

Griffiths: Based on experience with firms already under the new rules, it is fair to say the picture is very mixed. However, two factors are notable. Firstly, the personal accountability, including being criminally accountable, is having the effect of senior managers being actively engaged in their areas of accountability. Secondly, the requirements of new rules for greater focus on competence is causing firms to review the rigour of their underlying processes, for example measuring competence, external recruitment, and so on. While varying from firm to firm, these things are slowly influencing the culture of firms. We are seeing a greater focus on regulatory references, for example, which is preventing instances of 'rolling bad apples' – unsuitable staff being able to move between firms.

R&C: As far as developing a firm's approach to implementing SM&CR, what steps will firms need to take to determine who will hold a Senior Management Function (SMF), who will be within the Certification Regime, and who will be unaffected?

Pardy: Consider who holds a current Controlled Function (CF) or Senior Insurance Manager Function (SIMF) and see who will map across in line with PRA or FCA published guidance; this will mean the individuals can be grandfathered across rather than have to apply as if for the first time. Carefully consider those SMFs that will need to be allocated where, as a firm, you did not need to previously allocate them. Where it is identified that your organisation needs to allocate a new SMF, consider the knowledge, skills and experience already in-house. Do you have a suitable candidate, or will you need to employ someone new? In respect of the CR, identify which SHFs apply to your business. Once you have these confirmed, you can then consider which employees fall into each category. But also bear in mind that it is acceptable for an employee to fall into more than one SHF, so do not just assume they will only be categorised in one SHF area. As Certification covers not only those who line-manage a certified person, but also those who supervise a certified person, any assessment process set up to identify this particular population needs to consider both angles. On a final note on this topic, firms' personnel are changing all the time. When you are next recruiting for an appropriate role, consider looking at individuals who have helped implement SM&CR in the banking sector, as their knowledge could certainly kick-start your project.

James: The ability to model up the Senior Management assignments and Governance Structure is essential to ensure coverage. This, combined with a skills and experience matrix for each of the senior managers, will determine which senior managers are most suitable for each role. The ability to easily prompt the SMR and CR communities into action when required, and to monitor their completion, will significantly reduce the burden of scheme administration and reduce risk. A system solution also provides peace of mind as each senior manager can see where they sit in the structure and the ability to safely store data as evidence of Reasonable Steps. This provides a one-stop shop for administration and recordkeeping for the regime.

Dent: Defining the shape of your governance structure in preparation for the new regime is one thing, but I would encourage firms not to underestimate the potential dynamic and changing nature of the senior management team and the details of the governance structure as the firm evolves and continues to operate. The administrative task of tracking and evidencing changes and updates is potentially significant. A 'time boxed' and diarised history of changes, rationales, attestations and evidence is key. With regard to certified staff, firms need to ensure they fully consider the implications of robustly managing and evidencing competence.

Griffiths: Although most SMFs convert quite readily from the previous APR, there is often debate about executives holding certain CFs, for example current CF29, Significant Management Responsibility and, to a lesser extent, CF28, Systems and Controls. The second area, ahead of implementation, is that firms' ideas on how many roles should be included in certification often swing wildly. In the banking sector, we have experienced potential employees caught by Certification vary by several hundred ahead of go-live. Although the FCA has stated it does not expect the number of roles within Certification to be large, ultimately the actual numbers proposed by a firm is a judgement, often underpinned as much by attitude to risk and as it is by the firm's business model.

R&C: What steps should solo regulated firms take at this stage to prepare for the introduction of the SM&CR? What advice would you offer on modifying their internal processes and procedures to ensure a smooth implementation of SM&CR and being able to realise business benefits from this regulatory change?

Pardy: Ensure that you identify your project sponsor at the outset. Ensure that they hold an SMF Function and so have the authority to oversee the implementation on behalf of the board. Get your project budget early. FCA research suggested that it was likely to cost an Enhanced Firm in the region of £450,000 to implement SM&CR. Our experience suggests that you might well find you need quite a bit more. To try to ensure that your business gains real business advantage from the implementation of SM&CR. Consider what processes might not work for you as effectively as they could, such as performance appraisal. Consider how these could be enhanced, as they will need to be an integral part of the Certification process.

James: While smaller firms could manage their structure and assignments on spreadsheets in the short term, in time it will be increasingly difficult to manage the history and audit trail of changes to the business. Therefore, robust record keeping is essential. Mid-size firms and upwards really should consider this as essential from the outset. Firms should also have robust Competency schemes to manage and monitor all employees, with the possibility of an increase in training and coaching to mitigate risk of Conduct Rules breaches. While this may increase costs, the outcome, if applied well, may drive a transparent and fair level playing field for both firms and consumers in financial services.

Dent: I would emphasise the need for firms to consider the administrative burden of managing high numbers of checks, validations, attestations and administrative records, such as evidence of Reasonable Steps and delegated activities. Will you be able to confidently attest that your systems, processes and reporting are robust, consistent and reliable?

Griffiths: My advice would centre almost entirely on the SM&CR implementation project and would focus on five things. Firstly, think hard about whether the firm has the level of regulatory expertise internally to guide the project from a technical perspective. If the answer to that question is anything other than an unwavering 'yes', then do not hesitate to seek experienced external support for the duration of the project. Secondly, ensure that the project secures sufficient resource, both financial and staffing, to ensure success. Also, that the people staffing the project represent the main stakeholder groups, compliance, risk, operations and HR. Thirdly, ensure that the project has some professional project management resource assigned to it. This will ensure it stays on track. Fourthly, start at least nine, ideally 12, months ahead of the go-live date. Finally, ensure that the project secures sponsorship from the 'top table', ideally at CEO or COO level. Although these suggestions may appear obvious, our experience of projects that struggled in the banking sector were invariably caused by one, or several, of these factors being missed.

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R&C: Going forward, what long-term implications do we expect SM&CR to have for the financial services industry? In your

experience, are firms generally ready and willing to embrace the regime and the impact it will undoubtedly have on a firm's people, processes and operations?

Pardy: Many NEDs are using this as the opportunity to step down from a pre-approved role as they do not want to take on board the higher perceived personal accountability. There is a shortage of pre-approved NEDs as people migrate to the lower level of accountability by becoming a Notified NED only. There is a greater focus from senior managers on those areas where they know they will be held to account. We have seen a move within compliance and risk teams for greater funding and resource to manage the greater level of regulatory responsibility. There is a greater dividing line between a group parent and regulated subsidiary where either there is more 'blue water' between strategic oversight and direction or the affected senior managers within the group parent becoming an SMF on behalf of the subsidiary. In the longer term, and impacted by the Certification Regime, there will be less use of split supervisory structures as this increases the numbers within the CR and the cost of running it. On a final note, and one not yet realised, is the legal challenges from those that have had to leave the industry due to Regulatory Reference issues perceived to have arisen as a result of a previous employer's response to a request for reference.

James: As the underlying theme of SM&CR is all about competence and accountability, we have started to see a move from firms to review, assess and improve their current competence assessment processes across the piece. Firms have realised that without robust competence assessment processes underpinning the needs to evidence Fitness & Propriety for many employees, they can never hope to meet the requirements of the new regime.

Dent: I would warn against the burden of complex and inefficient processes and procedures in the long term. Firms should plan to protect themselves against the risks and costs of disjointed systems and processes that will become increasingly challenging to maintain in the longer term. Future-proofing processes and solutions is key to minimising risk and the potential for an ever-increasing administrative burden. Change and evolution is likely within both the regulatory landscape and even within the structure and environment of individual firms themselves, so organisations need to consider their best routes to achieving the required level of flexibility. Considering the most practical way to manage the day-to-day tasks and challenges of SM&CR will become increasingly clear. Ideally, this will force decisions that create seamless processes, and deploy systems that span multiple functions and departments, maximising efficiency and, crucially, enabling transparent and robust audit trails.

Griffiths: It is likely that senior executives will be more cautious before accepting the responsibilities that come with being in the SMR. Indeed, the new rules may cause some current executives to step down or retire early. To a lesser extent, the same may well be true of staff caught in the CR. It may well be that firms experience some level of wage pressure as staff demand more for the increased level of scrutiny demanded by the new rules. Finally, firms will increasingly focus on their internal processes – regulatory references, appraisal, and so on – and tighten them up to avoid the risk of falling foul of the regulation. R&C