

PRA review of SM&CR – What can we learn?

By Julie Pardy from Worksmart

Last December, the PRA issued the results of its review into the implementation of SM&CR in dual-regulated firms, i.e. Banks, Building Societies, Credit Unions and Insurers. As SM&CR has been applicable to many firms since 2016, this feedback is helpful in understanding what impact the implementation has had. Dual-regulated firms have lived with SM&CR for a reasonable period of time now and so are better able to comment on their experiences. It was also interesting to get a view from those that supervise the regime, and no doubt many firms were interested to hear how PRA supervisors found working with the components of the regime through their supervisory duties. The PRA were interested to understand how the day-to-day operation of SM&CR versus the regulators original objectives had been met and to find out if there were any unintended consequences of the regulation. To do this, data was collected from PRA supervisors, interviews were held with practitioners, advisers and supervisors and a sample of 140 firms were invited to get involved. The questionnaires sought responses from both senior managers, i.e. those overseeing the implementation of the regime, and those responsible for the actual implementation the regime. The study produced some very interesting results which the review summarised into three themes and nine recommendations:

Theme 1:	
Holding individuals to account through SMC&R Several factors have combined to have a demonstrable and positive effect on behaviour, notably using fitness and propriety (F&P) checks to control 'entry into the system' and using the behaviours within SM&CR as a supervisory tool. Indeed 90% of senior managers and those implementing the regime felt that the regime captured the correct individuals and over 90% felt that behaviour had changed for the better. However, some challenges were reported. Although over 90% of firms reported that SM&CR had been incorporated into their business-as-usual practices in some way, only just over 50% felt that this went beyond simple regulatory compliance. Also, on the subject of regulatory references, although 60% of firms felt that references were 'mostly' of sufficient quality to help them make F&P decisions, only around 25% of firms felt that this was always the case.	Follow-up and recommendations Regulatory References: The regulator should engage with the industry clarify expectations around reporting misconduct in references and for the industry to ensure references are both provided and used in an appropriate manner. Remuneration: The regulator should seek feedback on the benefits of clarifying the link between SM&CR and remuneration as a way of further embedding SM&CR into business-as-usual practices. Senior Manager Expectations: Senior managers responsible for the Senior Manager and Certification Regimes should focus on the embedding of the regimes into everyday life in their firms.

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Lessons to Learn

Whilst the review identified generally good news in that firms felt SM&CR had changed things for the better, two key lessons stand out for me:

1. On an operational level, firms are still challenged by regulatory references because, by nature, firms providing references will respond to the specific info requested, i.e. often ‘yes’ and ‘no’ questions, and be careful not to say anything potentially discriminatory. This places the onus on the ‘receiving’ firm to request more information should they have questions or concerns. The British Standards Board produced a guidance paper on regulatory standards in September 2019. On page 10, it states; “While a template has been provided by the FCA for firms to use, firms are not prevented from asking for more information than is included in the template”. Firms should use this guidance to provide themselves with the level of information they need to reassure themselves they are not potentially recruiting a ‘rolling bad apple’.
2. On a wider level and more significantly, much work is still required to ensure SM&CR is more than an exercise in regulatory compliance, i.e. more than a ‘tick box’. Indeed, messages from both regulators, particularly the FCA, are focused on SM&CR being the catalyst for creating wider culture change in financial services. If so, linking reward to displaying the appropriate behaviours and ensuring the appropriate senior managers really take ownership for embedding SMR and Certification are important, but only in the context of them being enablers for creating wider change.

Theme 2:

Myth busting and clarifying expectations

There was a strong view from respondents to the survey that significant changes to SM&CR were not required, even to the extent that further guidance on responsibilities might be counterproductive, i.e. take away from senior managers exercising judgement. Alongside this, the survey asked whether the specific individual responsibilities in SM&CR were, in fact, seen as complementary to the principle of collective responsibility at board level. Whilst no clear evidence was forthcoming, some respondents identified some tensions between individual and collective responsibility.

Another concern, which was identified when drafting the SM&CR regulation, was that the specific requirements of SM&CR would, in practice, impede the regulators' desire for greater diversity. Whilst the survey identified no clear evidence of this, it was noted that the temptation to recruit and promote individuals similar to those already in post, i.e. playing it safe, remained a real risk to be guarded against.

Finally, the survey identified some desire for greater clarification on the operation of the 12-week rule, i.e. interim appointments to Senior Manager posts.

Follow-up and recommendations

Diversity: The PRA reiterated its desire for a diversity of skill and experience at senior management level and committed itself to finding better ways of collecting data on diversity.

Collective Responsibility: Again, the PRA committed itself to collecting more data in this area to establish whether the individual accountabilities as defined in SM&CR, together with the established and legal principle of collective responsibility are mutually reinforcing or creating tensions.

Interim Appointments: The PRA and FCA are consulting on the need to clarify their expectations of firms when senior managers take extended temporary leave, i.e. longer than 12 weeks.

Lessons to Learn

The key lesson in this area is around diversity. Both the PRA and FCA talk extensively about the need for greater diversity at board level in financial services believing that, as Anna Sweeney (Executive Director, Insurance Supervision) said of the 2008 financial crisis;

“The lack of intellectual diversity, including from the lack of gender, race and other diversity, we believe contributed to the severity of the crisis through confirmation bias”.

When both recruiting externally and promoting from within, firms should guard against the tendency to ‘play safe’ and champion candidates who reflect the status quo.

Theme 3:

Application of SM&CR to different business models

The SM&CR regulation is designed to be proportionate depending on size of the firm. When asked about this, respondents as a group, almost 80%, agreed that SM&CR was sufficiently proportionate for their firm. However, this figure reduced, albeit by a few percentage points, for respondents in smaller firm categories.

However, the PRA noted differences in the application of Senior Manager Functions, e.g. that SMF6, Head Of Business Function, was used extensively (90%) in deposit taking and investment firms but less so in insurers.

The survey also provided limited feedback on a range of subjects, e.g. the allocation of Prescribed Responsibilities to FCA senior manager roles, administrative burden of updating the regulator with up to date SoRs and MRMs for smaller firms and the use of the SMF7, Group Entity Senior Manager. In these cases, the PRA committed to seek further views and provide further guidance.

The PRA also noted two other factors, notably the limited use of time-limited and conditional approvals since the implementation of the regime in 2016. In addition, that there was no single place where firms could review the various Supervisory Statements or letters calling on firms to assign responsibility for particular risks to one or more senior managers, e.g. crypto-assets. The PRA committed to provide further guidance and update its website accordingly.

Follow-up and recommendations

Allocation of responsibilities: The PRA committed itself to seek further views on:

SMF6 – why it isn't used as widely in insurers.

Key Function Holders – how the designation of these roles works alongside SM&CR.

Prescribed Responsibilities – whether further guidance is required.

Proportionality – whether smaller firms could submit SM&CR documentation less frequently.

Time limited and conditional approvals: The PRA will explore options for greater use of time-limited and conditional approvals.

New senior manager expectations: The PRA should consider creating an inventory on the Bank of England website where all new and emerging risks can be listed.

Finally, wherever possible, the PRA committed to staying within the existing framework to prevent limit its growth and complexity.



Lessons to Learn

Many of the lessons revolve around the PRA committing itself to more dialogue with the industry which may, in turn, create further guidance in the future. On a practical level, however, smaller firms will be looking to the PRA to provide guidance that will lessen the administrative burden of reporting.

How RegTech Can Help

Both the PRA and the FCA view RegTech, i.e. the use of technology to help firms with regulatory compliance and costs of that compliance, as a key enabler in the embedding regulation, SMCR included.

Worksmart's dedicated and multi-award winning SMCR solution, Accord, has been specifically designed to provide firms with functionality to manage the detailed day to day management of the regime quickly and simply. This is important for two reasons; firstly, smallest firms aside, most firms' SMCR regime will require hundreds if not thousands, sometimes tens of thousands, of individual activities to be administered, recorded and reported on each year. Without dedicated software to manage and record these activities, the administrative costs are significant. Additionally, by not using a bespoke SMCR system, firms increase their risk of non-compliance and, potentially, fines by missing key activities. Simple examples of these are;

- Not collecting and following up on references for newly recruited staff
- Not informing the FCA of a senior manager temporarily holding a Prescribed Responsibility for more than 12 weeks (concessions due to Covid aside)
- Not completing detailed handover notes between senior managers when responsibilities are passed between them
- Not updating committee memberships and members' responsibilities
- Not collecting all the necessary information to complete a thorough F&P review of an individual etc.

RegTech solutions like Accord will alert and chase administrators and central teams if activities like these, risk either not being done, being overdue or substandard.

When adopting Accord, firms can expect:

- More accurate and timely record-keeping
- More efficient processes, so saving time and cost
- Greater governance and oversight

Using Accord enables administrators and central teams to 'step away' from simply administering the SMCR rules to concentrate on oversight and the qualitative assessment of processes. When teams have the space and time to do this, they can concentrate on preventing breaches, support teams that are struggling and generally work to better embed the regulation.

Whilst SMCR RegTech solutions like Accord cannot solve wider issues identified in the report such as diversity, by efficiently managing 'the day-to-day', they create the time and space for central teams and senior managers alike to concentrate on these wider issues.

To read the report in full:

<https://tinyurl.com/2pcfu5js>

BSB "Statement Of Good Practice – Certification Regime Regulatory References" <https://tinyurl.com/mhbcy55a>