



Hogan  
Lovells



The Senior Managers and  
Certification Regime:

An Introduction for Private Equity Firms



# 1. Overview

- 1.1 The Senior Managers and Certification Regime (“SMCR”) governs the appointment and conduct of senior and key personnel at banks and PRA-authorized investment firms. The SMCR is a new regime which was developed following criticism levied against the FCA’s approved persons regime by the Parliamentary Commission on Banking Standards, and is intended to make senior personnel and key staff more accountable for their actions.
- 1.2 While the SMCR currently only applies to banks and PRA-authorized investment firms, the SMCR is in the process of being extended to apply to all authorized firms. This is likely to have a significant impact on compliance arrangements at affected firms when the extension takes effect in 2018.
- 1.3 Private equity firms should be aware of the SMCR, as it will affect their own governance arrangements if they are themselves authorized firms or are within authorized groups. It may also affect authorized firms in which private equity firms invest.
- 1.4 While the detailed FCA and PRA rules for the extended regime have not yet been released, we would expect the extended regime to be similar to the regime currently applicable to banks and PRA-authorized investment firms. Key aspects of the extended regime are expected to be as follows.  
**The Senior Managers Regime:**
  - (a) Individuals appointed to perform designated Senior Management Functions will require regulatory approval before commencing their role.
  - (b) Senior Managers will also be required to have individual Statements of Responsibilities setting out their personal responsibilities. The Statements of Responsibilities must be submitted to the regulators.
  - (c) The regulators will prescribe a number of core responsibilities that must be allocated among the Senior Managers of the firm.
  - (d) Firms must maintain a Responsibilities Map, outlining the governance structure of the firm, including reporting lines and the responsibilities of the Senior Managers.
  - (e) A Senior Manager will have a “duty of responsibility” to take reasonable steps in relation to areas for which that Senior Manager is responsible. Where a problem arises within the scope of a Senior Manager’s allocated responsibilities, the regulators can take action against a Senior Manager who has failed to act in line with this duty of responsibility.

**The Certification Regime:**

- (a) There will be a new “Certification Regime” to cover staff who are not performing Senior Management Functions, but who are in a role which could cause “significant harm” to the firm or its customers. Under this regime, firms will be required to certify that the individuals are fit and proper to perform their roles.
- (b) The certification will be required to be repeated at least annually.
- (c) A Senior Manager must be responsible for the implementation of the certification process.

**Regulatory References:**

- (a) There will be new rules governing the way in which firms assess the fitness of Senior Managers and Certification Regime staff. In particular, firms seeking to appoint a Senior Manager or certified person must request a regulatory reference covering such person’s employment for the previous six years.

**The New Conduct Rules:**

- (a) The majority of staff within a firm will be required to comply with new Conduct Rules.
- (b) The only staff who are not required to comply will be those performing ancillary roles (being those roles not involved in the performance of the firm’s regulated business).
- (c) Firms will be required to ensure that all relevant staff are trained on the implications of the Conduct Rules.

## 2. Why is this relevant to my business?

### Private equity firms that are authorised

- 2.1 FCA-authorised firms are currently subject to the FCA's approved persons regime, which governs the appointment and conduct of senior management and other key personnel. The SMCR will replace this when it is extended.
- 2.2 The extension of the SMCR will directly affect private equity firms that are authorised by the FCA. It is also of direct relevance to directors and employees of such firms, who may be subject to an increased focus on their individual responsibilities and their accountability for such responsibilities.
- 2.3 There are significant differences between the SMCR and the current FCA approved persons regime; in several respects the SMCR is a more onerous regime. To comply with the SMCR, FCA-authorised firms will need to make changes to governance documentation, compliance and HR procedures and processes, and submit additional documentation to the FCA. There may also be implications for employment contracts and terms of appointment of directors. Please see further details below.

### Private equity firms which acquire authorised entities as targets

- 2.4 The extension of the SMCR will also affect private equity firms which acquire targets that are themselves FCA or PRA authorised. These targets will be required to make changes to their governance documentation, compliance and HR processes, and to make submissions to the regulators, which may result in legal and compliance costs.

- 2.5 The precise impact of the SMCR will depend on the nature of the target firm's regulated business.
- (a) In the case of FCA-authorised firms, the SMCR will replace the current approved persons regime, as described in paragraphs 2.1 to 2.3 above.
  - (b) Insurers are currently subject to a different regime called the Senior Insurance Managers Regime. The SMCR will replace or amend this regime for insurers and insurers will need to adjust their governance and compliance arrangements accordingly.
  - (c) Banks and other firms that are already subject to the SMCR will likely not be significantly affected. However, other changes are being made to the existing SMCR as part of the regulators' post-implementation work, and such firms will need to ensure they remain compliant.

### Private equity firms which have authorised entities within their groups

- 2.6 Private equity firms which have FCA or PRA authorised entities within their groups may also be affected. Under the SMCR, as it currently applies to banks and PRA-authorised investment firms, directors or employees of group companies who have a significant degree of control over the activities of an authorised firm subject to the SMCR will need to be approved as Senior Managers pursuant to a "Group Entity Senior Manager" function. This is also expected to apply under the extended regime.

## 3. What are the key elements of the SMCR?

### Senior Managers must be approved

- 3.1 A person who performs a designated “Senior Management Function” must be approved by the PRA/FCA.
- 3.2 The PRA/FCA will need to specify in their rules what these functions will be under the SMCR when it is extended to all firm types. However, these functions are likely to be similar to the list already designated under the existing SMCR applicable to banks and PRA-authorized investment firms. Please see the Annex to this note for a list of the existing SMCR functions, as an indication of the kinds of roles that may be covered when the regime is extended.
- 3.3 The good news for FCA-authorized firms (such as private equity firms and FCA-authorized targets) is that fewer persons may require prior regulatory approval under the SMCR than under the current approved persons regime.
- For example, under the approved persons regime, all directors (including non-executive directors) must be approved persons. In contrast, under the SMCR as it currently applies to banks and PRA-authorized investment firms, non-executive directors who do not also undertake one of the roles designated as Senior Management Functions do not require approval.
  - There is also no equivalent to the approved person (CF30) role (customer function) under the SMCR.
- 3.4 The impact on insurers that are currently subject to the senior insurance managers regime is less clear. As the senior insurance managers regime already includes a similar list of “senior insurance management functions”, it is not clear whether this list will be amended as part of the extension of the SMCR. It is possible that if an insurer has persons approved to undertake FCA approved functions (rather than senior insurance management functions), some of these persons may no longer require regulatory approval for those functions under the extended SMCR.

- 3.5 Firms will likely need to apply to have individuals who are already approved persons or senior insurance managers to be ‘grandfathered’ into the nearest corresponding Senior Manager Function when the SMCR is extended. Any firms planning a new Senior Manager appointment, or a material change in role for currently approved individuals, will need to prepare and submit an application to the regulators for approval.
- 3.6 When applying to the regulator for approval, firms must submit a Statement of Responsibilities indicating the Senior Manager’s responsibilities. Please see paragraphs 3.11 to 3.13 below for more information.

### Other key employees must be certified

- 3.7 The SMCR requires firms to certify persons who are not performing Senior Management Functions, but who are employed in positions where they could pose a risk of significant harm to the firm or any of its customers. The firm must prepare a certificate indicating that it is satisfied that the person is fit and proper for the relevant role. The certificate must also set out the aspects of the affairs of the firm in which the person will be involved in performing the function. When assessing fitness and propriety, the firm must consider the person’s qualifications, the training the person has had or is receiving, and the person’s competence and personal characteristics. The certificate is only valid for 12 months, which means that individuals must be re-assessed and re-certified on a yearly basis.
- 3.8 While the extension of the SMCR to all FCA-authorized firms may mean that, in some cases, fewer people at these firms may need to be formally approved by a regulator, the Certification Regime is likely to cover all current approved persons and may also cover individuals who are not currently approved persons.

- 3.9 Firms will need to consider which of their employees will require certification, and update their compliance policies and HR processes to take account of the certification process. The certification/assessment processes could be built into firms' annual staff appraisal processes. An approved Senior Manager will need to be allocated responsibility for the implementation of the certification process.

### **Senior managers must be allocated responsibilities**

- 3.10 One of the main themes of the SMCR is the increased accountability of individual Senior Managers. As part of this, firms are required to maintain several documents which highlight how responsibilities are allocated amongst senior personnel.

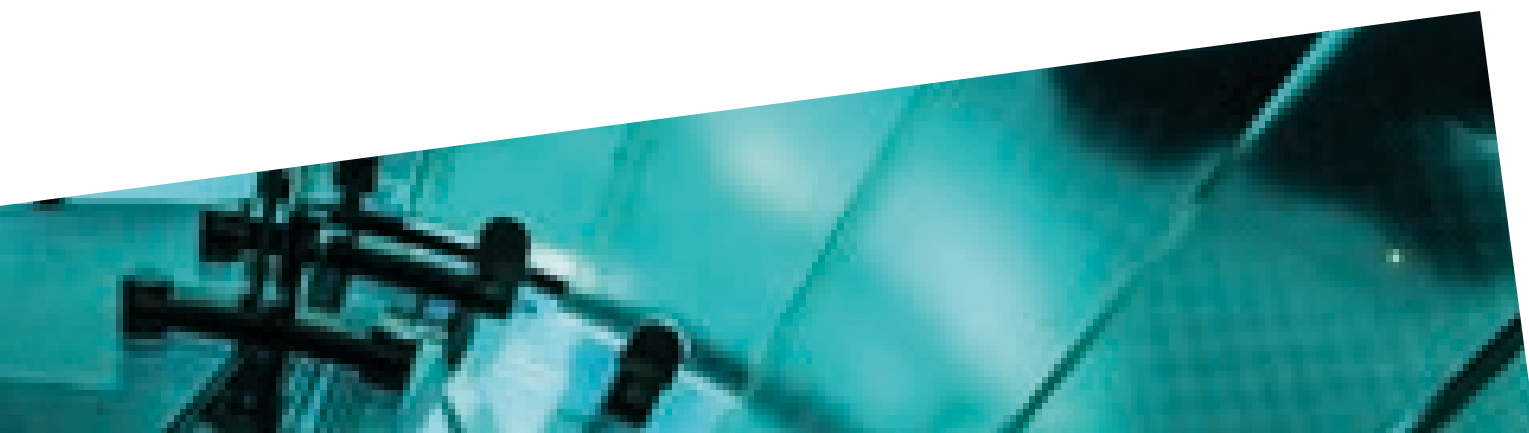
#### Statement of Responsibilities

- 3.11 Firms will need to maintain a Statement of Responsibilities for each Senior Manager and submit this when seeking approval for that Senior Manager. The Statement of Responsibilities is an important part of the SMCR framework and requires careful consideration.
- 3.12 The Statement of Responsibilities should identify the areas of a relevant firm's regulated activities for which the Senior Manager is responsible. We would also expect the regulators to consider whether the responsibilities listed in it are appropriately allocated to the relevant Senior Manager. Firms will need to consider issues such as the capacity of the Senior Manager, as well as potential conflicts between different responsibilities which may mean that they should not be allocated to the same person.

- 3.13 Under the current SMCR applicable to banks and PRA-authorized investment firms, firms are required to allocate certain prescribed responsibilities amongst their Senior Managers. There is an extensive list of prescribed responsibilities, which differs depending on the nature of the firm and its activities. However, examples of such prescribed responsibilities typically include (i) responsibility for compliance with the Certification Regime, (ii) responsibility for compliance with the Senior Managers Regime and (iii) acting as the "whistleblower's champion". Each Statement of Responsibilities would need to make clear which of these responsibilities have been allocated to the relevant Senior Manager. Certain prescribed responsibilities may only be allocated to a Senior Manager who is a non-executive director.

#### Responsibilities Map

- 3.14 Under the current SMCR applicable to banks and PRA-authorized investment firms, firms are required to maintain a management Responsibilities Map. We would expect the same requirement to apply to all firms when the SMCR is extended. This would affect FCA-authorized firms in particular, as insurers are already required to produce a similar map under the senior insurance managers regime.
- 3.15 The purpose of the Responsibilities Map is to provide an overview of the roles of Senior Managers and other senior personnel at a firm, and give a clear indication of their responsibilities. The map will also show whether there are any gaps in accountability, and indicate whether the firm has a clear organisational structure.



3.16 The Responsibilities Map must list all Senior Managers and other senior personnel and specify their responsibilities. The map will therefore need to be consistent with the various Statements of Responsibilities. As part of this, firms need to ensure that all relevant responsibilities have been allocated and that there are no gaps in accountability. Firms also need to consider whether responsibilities are allocated in an appropriate manner (see paragraph 3.12 above).

3.17 The Responsibilities Map must also contain detail on the firm's governance arrangements. For example, it should provide details of reporting lines and show how the firm is managed and the structure of decision-making. Where the firm is part of a group, it should make clear how the firm's governance structure interacts with the governance of the group.

3.18 In our experience, allocating responsibilities and preparing the Responsibilities Map and Statements of Responsibilities can be a complex and time-consuming exercise: there are a wide range of issues which need to be considered. It also seems to be an area where different firms have interpreted the requirements differently. This is reflected in the FCA's recent criticisms on the implementation of the SMCR by some firms. As part of a recent review of the regime, the FCA found that not all firms had properly carried out the requirements of the SMCR.

- (a) Some firms had allocated Senior Management Functions or particular responsibilities to staff who were too junior to hold such positions.

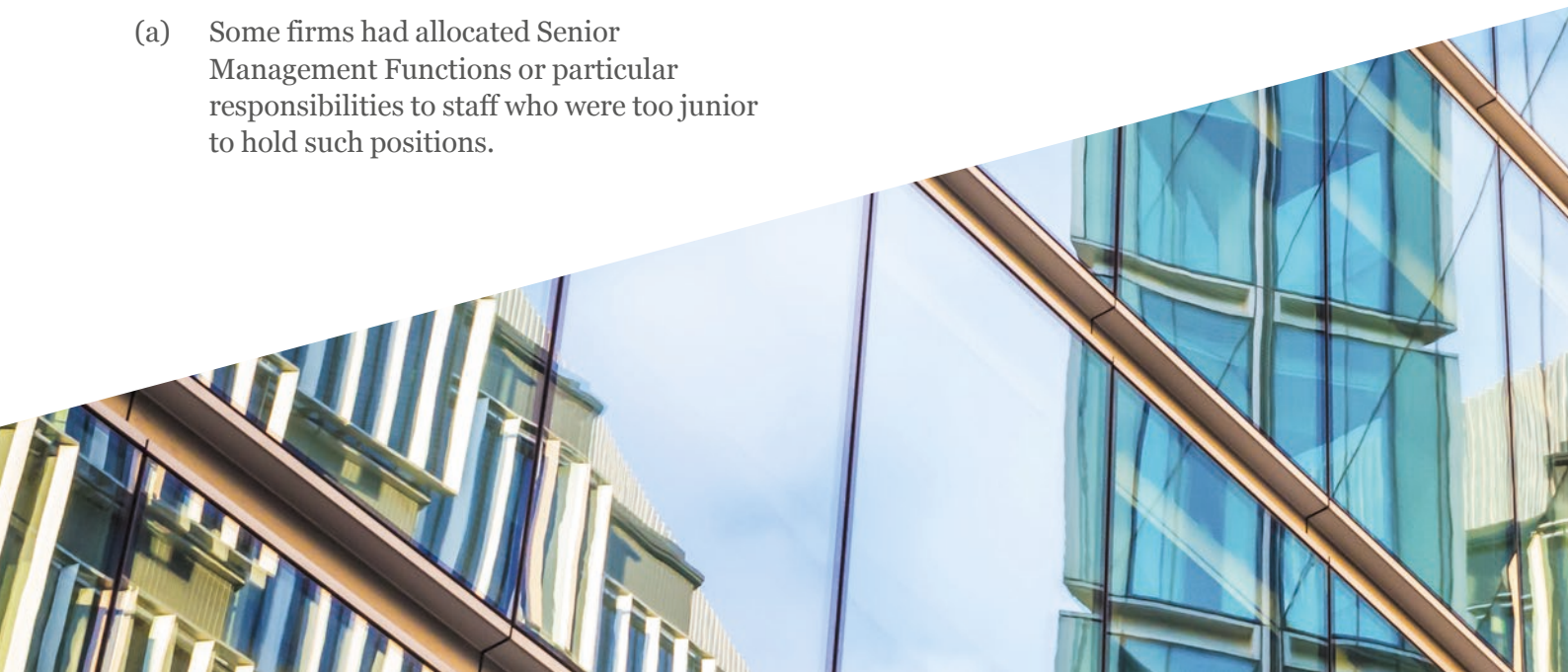
- (b) Some firms had failed to allocate all of the business functions and activities of the firm to responsible Senior Managers, resulting in gaps in the coverage of responsibilities.
- (c) Statements of Responsibilities for individuals and firm-wide Responsibilities Maps did not always set out clearly how responsibilities were allocated, or how reporting lines worked within firms.
- (d) A number of Responsibilities Maps did not give enough information about governance arrangements.

### **Senior managers have a duty of responsibility**

3.19 Under the SMCR, each Senior Manager will have a duty of responsibility in relation to areas within his/her responsibility (as identified in the Statement of Responsibilities). This means that:

- (a) if the firm has breached a regulatory requirement in an area within a Senior Manager's responsibility; and
- (b) the Senior Manager has failed to take such steps as a person in the Senior Manager's position could reasonably be expected to take to avoid the contravention occurring or continuing,

the PRA/FCA will be able to take action against that Senior Manager.





### **Employees are subject to new conduct rules**

3.21 The introduction of new conduct rules was a feature of the current SMCR. The extension of the SMCR is likely to involve the introduction of new conduct rules for staff of all other authorised firms. FCA-authorised firms which become subject to new conduct rules may need to make updates to compliance processes, employment policies and/or employment contracts to reflect this. Insurers are already subject to very similar conduct rules under the senior insurance managers regime. However, the extension of the SMCR may mean that the FCA rules are applied more broadly, to more types of person, than under the senior insurance managers regime.

### **FCA conduct rules**

3.22 The FCA conduct rules apply very widely to all employees except those performing ancillary tasks, such as receptionists, post room staff, security guards and cleaners. If a similar approach is taken when the SMCR is extended, this would mean that most of the staff in FCA-authorised firms will be subject to these rules. The FCA is currently also consulting on proposals to extend the application of the conduct rules to non-executive directors who are not Senior Managers.



3.23 Under the current SMCR, the FCA rules contain a set of individual conduct rules that apply to all in-scope employees, and a set of conduct rules that apply only to Senior Managers. The following rules apply to all in-scope employees under the current form of the SMCR.

- (a) You must act with integrity.
- (b) You must act with due skill, care and diligence.
- (c) You must be open and cooperative with the FCA, the PRA and other regulators.
- (d) You must pay due regard to the interests of customers and treat them fairly.
- (e) You must observe proper standards of market conduct.

3.24 The following rules apply to Senior Managers under the current form of the SMCR.

- (a) You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
- (b) 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.
- (c) 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.
- (d) You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

### **New rules on regulatory references**

3.25 Under the current SMCR, firms seeking to appoint a Senior Manager or certified person must request a regulatory reference. Assuming that this requirement will be extended to all firms as part of the extension of the SMCR, this may require changes to be made to firms' hiring processes and policies. This change will affect FCA-authorized firms which are not currently subject to the SMCR regime for regulatory references. In contrast, insurers are already subject to similar requirements under the senior insurance managers regime.

3.26 The key elements of the regulatory references rules are as follows.

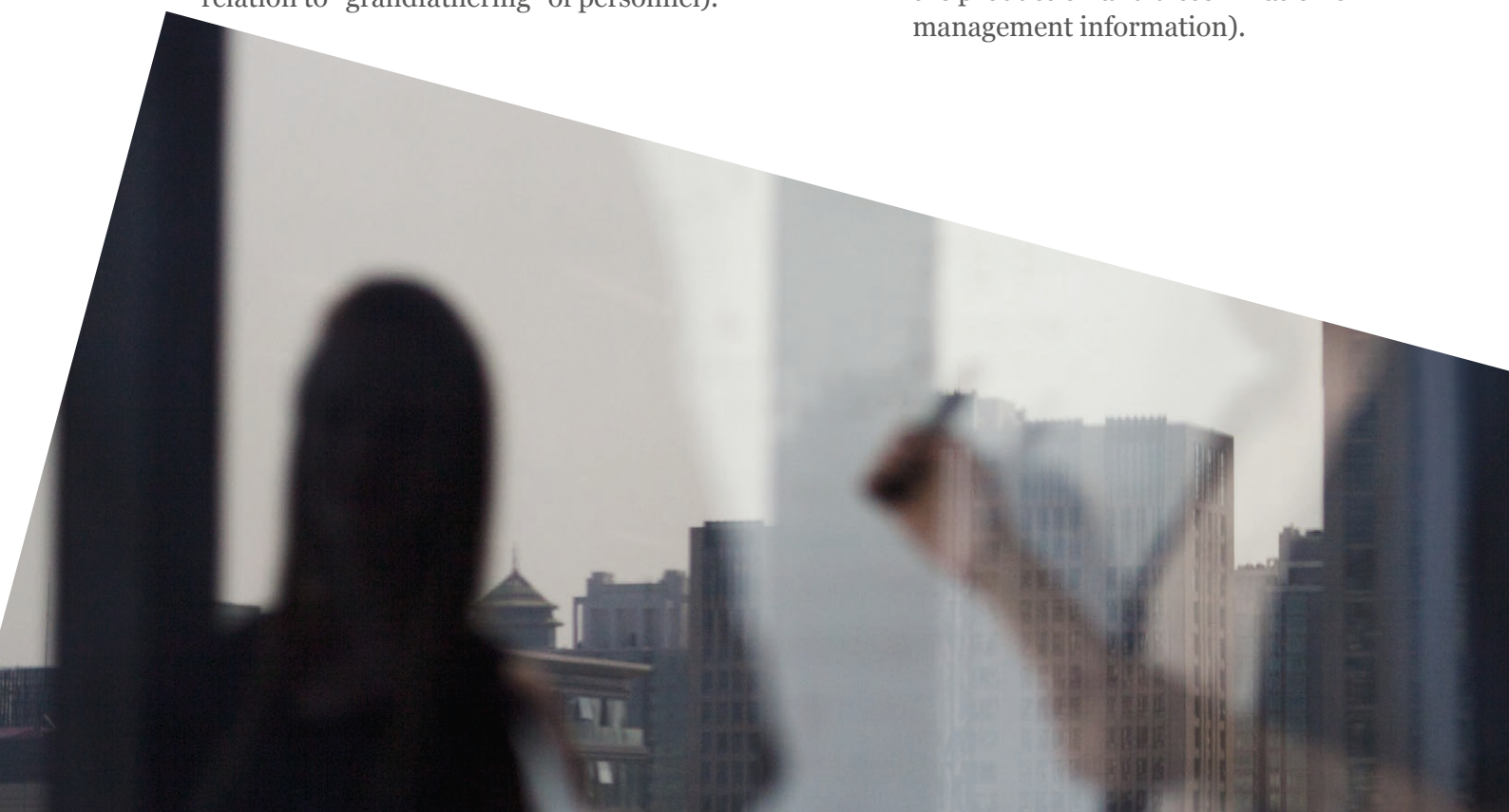
- (a) Firms must request a reference covering the person's employment for the previous six years. This applies even if the person's previous employers were not authorised firms.
- (b) Ideally, the reference should be obtained before an application for approval is made (for a Senior Manager), or before the person is certified in line with the Certification Regime.
- (c) There are also requirements for authorised firms to provide references on request. Regulatory references should focus on regulatory matters only, such as issues relevant to fitness and propriety or confirmed misconduct. The regulators have provided a list of information that should be provided.
- (d) Regulatory references must be provided in a specific template, and there is an obligation to update regulatory references issued in the prior six years if the firm becomes aware of information requiring the reference to be updated.

## **Enforcement**

When bringing enforcement action against a Senior Manager, the FCA will have regard to the Statement of Responsibilities and the firm's management Responsibilities Map when determining the extent of the Senior Manager's responsibilities in the firm. As well as a financial penalty or public censure, the FCA has the power to impose other disciplinary measures on individuals - such as a suspending, restricting or limiting, or imposing conditions on, their activities, including the power to vary FCA or PRA approval for the performance of a senior management function. One positive aspect to note is that the criminal offence of recklessly causing a financial institution to fail, which currently applies to banks under the SMCR, will not apply to other types of firm when the SMCR is extended.



## 4. What should firms do next?

- 4.1 The detailed rules which will govern the extension of the SMCR are not yet available, so firms should review these rules when they are released, and consider whether to participate in consultations on these rules (where relevant). We will publish further information when these rules are available.
- 4.2 Depending on the specific rules that are released, firms subject to the extended SMCR should expect to take the following actions to prepare.
- (a) Identifying how their personnel will need to be treated under the new regime, which will include identifying staff who will be Senior Managers, Certification staff and persons subject to the conduct rules.
  - (b) Conducting a reassessment of their governance arrangements (for example, to assess whether current reporting lines and allocated responsibilities are appropriate, and what the impact will be on group governance / matrix management arrangements).
  - (c) Preparing Statements of Responsibility, the Responsibilities Map and any required submissions to the regulators (such as in relation to “grandfathering” of personnel).
  - (d) Reviewing the impact of the new regime on internal controls and procedures. In particular, there will be a need to ensure there are procedures to cover:
    - (i) the maintenance of Responsibility Maps;
    - (ii) handover arrangements for persons moving into and out of Senior Manager roles;
    - (iii) assessment procedures for Senior Managers and Certification Staff; and
    - (iv) HR and disciplinary procedures.
  - (e) Senior Managers may want to negotiate their individual Statements of Responsibility.
  - (f) Senior Managers may also want to establish arrangements to ensure that they are able to get assurance regarding the adequacy of the performance of functions falling within the scope of their Statement of Responsibility (which could lead to changes in arrangements for audit, internal risk reviews, and the production and dissemination of management information).
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## 5. How we can help

We can assist firms with a wide range of tasks in support of this activity.

### **This may include assistance with:**

- The interpretation of the requirements of the new regime and how the new regime will apply to your particular firm and other firms within your group, and on internal governance arrangements.
- The assessment of which roles constitute Senior Management Functions or significant harm functions.
- The development of individual Statements of Responsibility and Responsibility Maps.
- The development of internal procedures and policies to facilitate compliance with various aspects of the new regime, such procedures to verify compliance by Senior Managers with their Statements of Responsibility, assessment and certification processes, role handover processes or regulatory notification procedures.
- The development of training programmes for different populations of staff on relevant aspects of the new regime.
- The completion of approval request forms (including notification forms required under the grandfathering regime) and liaison with the regulators.
- Employment law advice, in relation to matters such as staff take-on processes, training, disciplinary procedures, regulatory notifications and references.
- Advice in relation to PRA or FCA enforcement action.

### **Employment Law Advice**

The implementation of the SMCR will give rise to a number of issues that will require attention from the perspective of employment law. The SMCR imposes regulatory requirements that will affect a wide population of staff in a more intensive manner than is the case under the current regime. You will need to consider how best to ensure that you can meet your requirements under the SMCR, whilst also minimising the risk of employment liabilities. Particular areas of focus may include:

- The recruitment of new staff, including Senior Managers. This will include ensuring that contractual provisions dovetail with the new requirements, consideration of the most appropriate means of updating Statements of Responsibility and the wider Responsibility Map, together with a strategy for dealing with candidates for Senior Manager roles who want to negotiate the scope of their Statements of Responsibility.
- Establishing appropriate procedures to ensure that the wider population of staff remain appropriately trained and supervised, and to identify and address suspicions of behaviour that could give rise to an obligation to notify the regulator.
- Establishing appropriate procedures for addressing any regulatory notifications required during or at the end of an individuals' appointment for a role (including in circumstances of dismissal).
- How to deal with requests for references for personnel who have moved on.



### **Contentious Regulatory Advice**

Our contentious regulatory specialists understand your business and the impact of increasing regulatory reform on your industry. We draw from our extensive litigation and investigations experience involving the PRA, the FCA and other agencies, in anticipating and resolving potentially contentious matters before they arise.

We work alongside our non-contentious regulatory specialists to assist in relation to any contentious issues arising in relation to the implementation of new regulatory regimes, such as the SMCR. We have excellent relations with the UK regulators. They know us: specifically, they know our advice will be straightforward and well-informed, and that while we defend our clients earnestly in any dispute, we have a sensible and pragmatic approach. Some of our partners have been seconded to regulators in the past, and bring that insight to bear.

### **Incentives and Remuneration**

We are also able to advise you on the application of the PRA and FCA rules on remuneration, if required.

### **Direct Advice to Senior Managers**

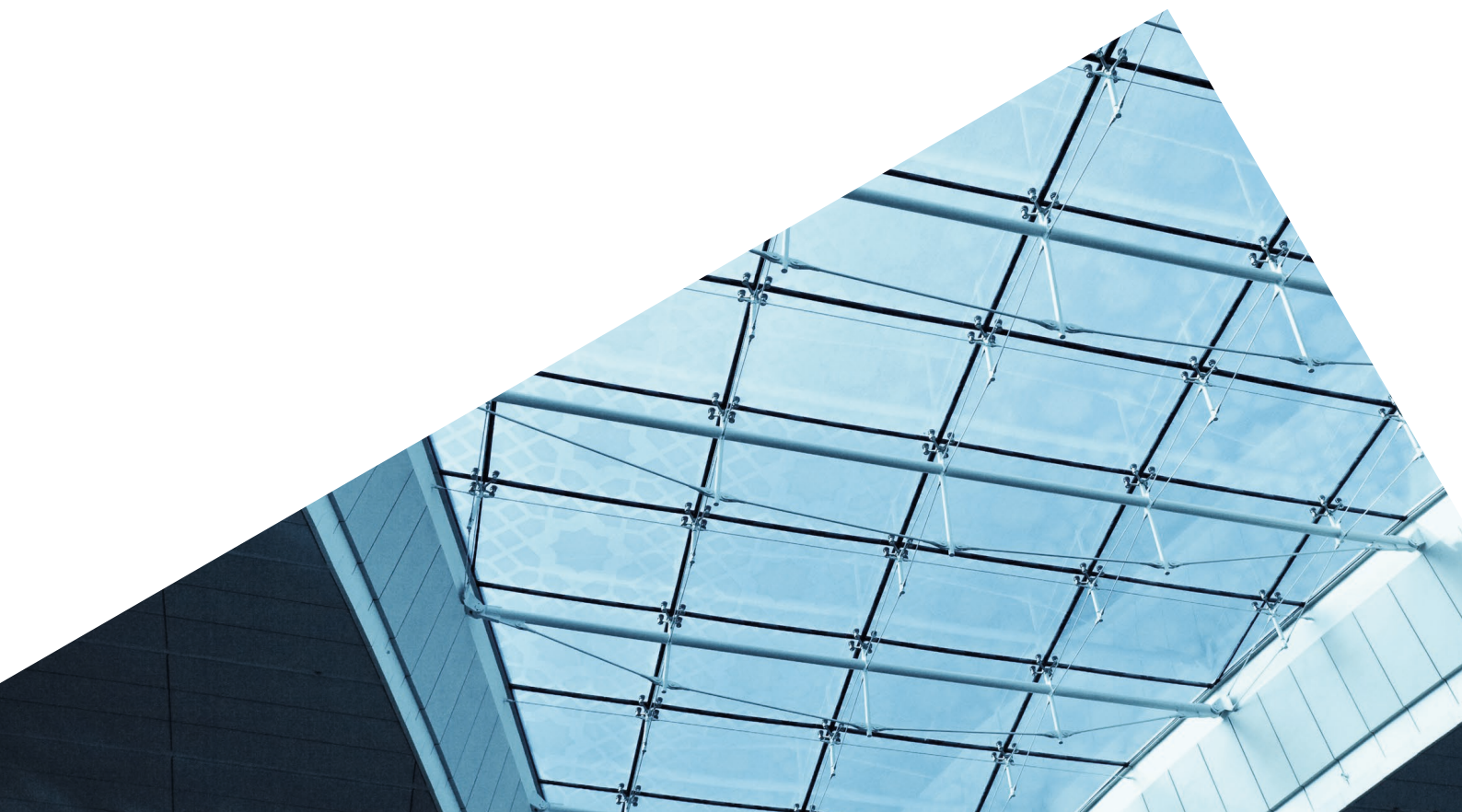
Senior Managers may wish to obtain legal advice on the implications of their proposed Statements of Responsibility. Subject to conflicts, we are happy to provide such advice.

### **Project Management**

We are fortunate in being able to offer our clients specialist legal project management assistance.

Our project managers can assist your firm to:

- clarify the objectives of the SMCR implementation project;
- identify the key deliverables required to successfully deliver the project and the deadlines for implementation;
- identify the inputs required from within your firm, Hogan Lovells and any other external third parties, in order to achieve each deliverable; and
- construct an efficient plan to ensure that the relevant deliverables and responsibilities are clearly mapped out, in an efficient manner, so that there is a clear roadmap to follow to implement the project.



# Annex

## List of current Senior Management Functions

1. SMF1- Chief executive function;
2. SMF2- Chief finance function;
3. SMF3- Executive director function;
4. SMF4- Chief risk function;
5. SMF5- Head of internal audit function;
6. SMF6- Head of key business area function;
7. SMF7- Group entity SMF;
8. SMF8- Credit union SMF (credit unions only);
9. SMF9- Chairman function;
10. SMF10- Chair of the risk committee function;
11. SMF11- Chair of the audit committee function;
12. SMF12- Chair of the remuneration committee function;
13. SMF13- Chair of the nominations committee function;
14. SMF14- Senior independent director function;
15. SMF16- Compliance oversight function;
16. SMF17- Money laundering reporting function;
17. SMF18- Other overall responsibility function;
18. SMF19- Head of overseas branch function;
19. SMF 21- EEA branch Senior Manager function; and
20. SMF22- Other local responsibility function.

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