The FCA and PRA
Senior Managers and Certification Regime – The new landscape

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About this report

This opinion piece is aimed at members of boards and operating committees, current SIF holders, in-house counsel and senior HR. It is designed to help you navigate the new landscape, to enable you both to address immediate strategic considerations and highlight your red flag areas.

We have prepared separate briefings covering the detailed analysis of the proposed Senior Managers and Certified Persons regime and an analysis of the clawback and remuneration changes. A further briefing on whistleblowing will shortly become available. All publications are available on request cleuma.nascimento@allenandover.com.
A regenerated regulatory regime has arisen from the ashes. Burnt by one financial disaster after another and fuelled by public and Parliamentary concern about trust, standards and culture, the new incarnation is unrecognisable. Firms have morphed into mini-regulators, alongside the PRA and FCA, and share their burden. The group whose behaviour is governed by a Code of Conduct has grown exponentially to include a much wider population. Responsibility and accountability for compliance, behaviour and culture is being placed into the hands of a few select individuals in the highest echelons of the bank and the buck stops with them.

And this is why, from now on, systems and processes, appraisals and performance management, supervision, training and compliance, fitness and propriety will be significantly different. If there were days of paying lip service to any of these, rest assured they are over. Instead of HR pushing these out to the business, the board will push them down and pull them back up. HR’s role has moved centre stage.
Timing and scope

The new regime will become effective at a date unknown in 2015 but our best guess is that this will be in the latter half of the year and probably the fourth quarter. We say this because of the amount of work still to be done by the regulators in terms of analysing their responses to the current consultations, which do not close until the end of October, and also the further consultations they need to hold about transitional arrangements and how far to extend the scope of the new regime to UK branches of foreign banks.

There is currently a regrettable lack of clarity about which banks are in scope which requires urgent resolution. At the moment, the proposals apply to UK-incorporated PRA-designated firms, UK-incorporated banks, building societies and credit unions, but the Treasury’s plan is to extend the regime (at the same time, eschewing a staggered approach) to all banks that operate in this country, including branches of foreign banks. This is also not something that can be done without further consultation. Given the need to plan the significant upheaval that design and implementation will bring, it is rather unsatisfying that crucial questions on timetable and scope are still “out there”.

Transition

An “all change” button will not be switched to green on a day in 2015, making the old regime disappear and the new one magically emerge from the cinders of sweat and toil that have given birth to it. There will be transitional arrangements but the precise details are not known at this time as they will be subject to consultation later this year.

In the meantime, the regulators have given an overview of how it will work for both Senior Managers and Certified Persons. Both involve due diligence of the current arrangements and how they will look under the new regime (see further under Management Responsibility Maps below).

The Senior Managers’ regime will only apply for new applicants. That does not mean that current SIF holders, who will be Senior Managers under the new regime, will be unaffected. Although approvals will not be required, Relevant Firms will need to notify the regulators of individuals’ existing SIF approvals under the Approved Persons Regime and their equivalent Senior Manager function. Their continued fitness and propriety will also need to be certified.

The only action required for Certified Persons is to identify those individuals who will be covered by the Certification Regime. There will then be a 12-month period during which to issue an annual certificate of fitness and propriety. This will accommodate the different appraisal cycles across the sector.
One of the most important strategic jobs that you can get on with now is to map out the organisational structure for regulated activity. This is likely to be a three-stage process reflecting the transition from the existing regime to the new one:

– First, the existing organisational structure needs to be mapped, noting where approved persons, and in particular SIF holders, fit into the structure and their chain of command for regulatory activity. If regulatory enforcement measures have identified shortcomings in supervision, accountability or systems and controls, these need to be highlighted on the map.

– Secondly, you need to create a transitional map, showing how the existing structure will work during the transition period. This will need to include all those individuals covered by the Certification regime who will need to be certified as fit and proper in the transitional period (see further under Transition above).

– Thirdly, create the Management Responsibility Map under the new regime which sets out the management and governance arrangements. Any gaps, particularly those identified under the first stage, will need to be plugged. It must be a single up-to-date document listing all approved Senior Managers, their portfolio of responsibilities (taken from their Statement of Responsibilities), reporting lines both upwards to the board and downwards to Certified Persons.

Ownership of this strategic activity should be by a current SIF holder or board member, whose equivalence would be a Senior Manager under the new regime. This is because the regulators require the responsibility of implementation of the new regime to be allocated to a Senior Manager (or between several of them). There is no hiding behind collective decision-making. Somebody within the bank will be accountable to the regulators for ineffective implementation.
Seriously, will there be many willing to meet the challenges of this new super Super Manager role? This is a role that will be intensely scrutinised at the approval stage. It is a role that is based on the presumption of senior responsibility, placing the evidential burden on Senior Managers to demonstrate that they took ‘reasonable steps’ to prevent, stop or remedy regulatory breaches. It is also a role with an increased likelihood of being sanctioned by the regulators, by public censure, financial penalties, withdrawal of approval, and the possibility of being banned from ever holding a regulated role again. And then there is the new criminal offence of reckless misconduct resulting in the failure of a bank, reserved exclusively for Senior Managers.

This combined with a tough remuneration regime that creates uncertainty around whether a bonus will be subject to clawback in the seven to ten years following award. It certainly gives the whispers from the financial sector corridors of “who wants to be a Senior Manager?” quite a degree of resonance.

Undoubtedly, there will be challenges to the role and some SIF holders or potential Senior Manager candidates will run for the unregulated hills or another sector. This will be most evident in non-executive and operational roles, which are easily transferrable to other sectors, or those roles with high risk-exposure. There are many women and men more than able to meet these challenges who are just waiting for the opportunity. Nevertheless, recruitment and retention of high calibre people for the Senior Manager roles is a red flag area.

This was acknowledged in the Europe Economics Cost Benefit Analysis of the new regime, which accompanied the regulators’ consultation paper. It points out that “large banks and investment firms, who are more exposed to international labour markets, are likely to be at a significant competitive disadvantage, vis-à-vis non-UK firms”.

Recruitment, whether by promotion or lateral hire, will be a protracted process, which needs to combine intensive care and smart negotiation. Rigorous evaluation needs to take place prior to the approval process to ensure that over-promotion or lack of experience due to the reduced talent pool is resisted.

Key to the success of this role, and ultimately the ability to attract and retain Senior Managers, will be the organisational structure, systems, processes and people that support it.

For most firms, the infrastructure is already in place but it will need refining in the light of the increased level of individual accountability, so that it is easy for Senior Managers and their delegates to oversee the function.

Reporting lines will be the critical element, which means that dotted, dual, or complex reporting lines should be avoided or explained so that there is clarity in the chain of command all the way up and down from the Senior Manager.

New layers of process may result in operational inefficiencies but will help with developing a robust monitoring and control system suitable for large firms with complex organisational structures. For example, an additional more formal procedure might need to be introduced to take account of annual fitness and propriety certificates. This could include:

- Certified Persons’ self-declaration that nothing has changed in the previous 12 months;
- Sign-off from designated managers that all processes feeding into annual appraisals have been checked and satisfied.

Additional support from HR practitioners specialising in regulatory people issues, could be assigned to Senior Managers to assist with the people systems and processes.
Sitting at the heart of the regulators’ new regime for Senior Managers are Statements of Responsibility (SORs), which set out those areas for which the Senior Manager is personally responsible and accountable. Sounds simple. Sounds straightforward. It is anything but. SORs are a red flag area as they are the linchpin that holds the complicated structure of regulation together. Stakeholders are invested in them for different reasons:

<table>
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<tr>
<th>Regulators</th>
<th>Regulators rely on SORs in the approval process to assess the appropriateness of the candidate to the listed responsibilities. SORs also play a vital role in management, supervision and enforcement as evidence of individual responsibility.</th>
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<tr>
<td>Senior Managers</td>
<td>An SOR is a transparent marker of personal responsibility – it is the open door through which all stakeholders will go for matters within its scope in relation to any queries or shortcomings.</td>
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<tr>
<td>Management of the Firm</td>
<td>Management of the firm will use SORs as part of the Management Responsibility Map jigsaw which demonstrates to the regulators that the overall picture of a firm’s management and governance arrangements are sound and robust, and indicate whether there are any missing pieces.</td>
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<tr>
<td>Certified Persons</td>
<td>Certified Persons will be part of the organisational structure articulated by SORs, and as such they will identify the relevant Senior Manager to whom regulatory queries should be directed.</td>
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<tr>
<td>Compliance/Risk</td>
<td>Compliance/Risk will use SORs along with Management Responsibility Maps as a route map to the responsibility chain of command where there are regulatory investigations or compliance issues within its scope.</td>
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<tr>
<td>In-house Counsel/Legal</td>
<td>In-house Counsel/Legal will view SORs as legal documents, using them as evidence of individual responsibility, as well as a risk management tool to help demonstrate that the firm’s risk areas have been allocated suitably.</td>
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Although an SOR is a Senior Manager’s portfolio and personal to the post-holder, its relevance, importance and divergent perspective to the various stakeholders will make it a fertile ground for tough negotiation. Senior Managers will be seeking to minimise their personal responsibilities, whilst the management will be trying to plug gaps and allocate more responsibility.

In view of the potential conflicts of interest, the consequences of breach, and the fact that the regulators need to be satisfied with the final version, SORs will need to be crafted and negotiated with care. It will be prudent for the firm and the Senior Manager to take separate and independent legal advice, the cost of which should be borne by the firm since SORs are a pre-requisite for the post.

Crafting an SOR is not a one-off job. It is a dynamic document, requiring constant review. It will need to be resubmitted to the regulators if there is a significant change.
Certified Persons

In a nutshell, Certified Persons are the old category of Approved Persons, minus some SIF holders who will become Senior Managers, plus others previously excluded but whom the regulators view as performing a “significant harm function”. Those persons classified as “Material Risk Takers” for the purposes of the remuneration rules on bonuses, deferral and clawback fall within Certified Persons. The category of Certified Persons has grown along with the Relevant Firm’s responsibility for ensuring they are fit for purpose.

There has been a shift in the balance of responsibilities between the regulators and Relevant Firms. Previously, the regulators were responsible for approving persons involved in regulated activity. The Relevant Firms played their part in doing their due diligence to satisfy themselves that the candidates were fit and proper persons, and by notifying the regulator by Form C if the person ceased performing a controlled function. But ultimately, approval and withdrawal was in the hands of the regulators. This has changed.

No longer will approvals by the FCA be required for Certified Persons. Instead the Relevant Firm will be responsible for “certifying” on an on-going annual basis a person’s fitness and propriety to perform the role. What is happening here is a shift in emphasis between the regulators and the Relevant Firms – the regulators are directing their resources to focus on the few individuals who are designated Senior Managers, who will be held accountable for the shortcomings of Certified Persons. And the Relevant Firm has almost become a mini regulator, taking on the primary responsibility as to the appropriateness of its regulated workforce.

It will be up to the Relevant Firm to certify a person or to withdraw or renew the certification.

Along with additional responsibility for Relevant Firms comes the burden of migrating the old system to the new, with IT systems, processes and procedures, guidance and training to support a more rigorous approach to fitness and propriety. This is a red flag area, requiring considerable thought, resources and time to implement and test a system that will require much more than box-ticking. The ultimate responsibility for its effectiveness will lie with a Senior Manager and the board, who will be looking for cast iron assurances as to its effectiveness.

Sounds simple. Sounds straightforward. It is anything but.
Regulated firms will be obliged to certify that all regulated persons (Senior Managers plus Certified Persons) are fit and proper to perform their role on an annual basis. To be clear on this obligation, the following should be noted:

– Fitness and propriety applies to a much wider population than previously.

– The previous rules on standards of fitness and propriety are essentially remaining the same. What is changing is the evidence required to assess and certify that the fitness and propriety standard has been met.

– Under the previous rules, fitness and propriety was an on-going obligation where the regulator would need to be notified if anything changed the position, and this would be factored into whether approval was maintained or withdrawn by the regulator. The on-going obligation continues under the new regime but it is the Regulated Firm which decides whether to certify or not.

– The well-established due diligence path carried out by Relevant Firms as part of the approval process and submitted to the regulator in Form A will be transferred to the certification process. The normal checks including criminal record checks, employment history going back five years with obligatory references from previous regulated employers, will remain the same.

What all this means is that it is much the same in terms of processes but there is more of it as it applies to a wider population. It also means that current systems and processes that will be engaged for certification (training requirements, disciplinary, grievances, regulatory whistleblowing disclosures) feed into an amended appraisal process. A system of annual declarations from regulated staff that there have been no changes to fitness and propriety will have to be introduced.

It will be crucial that regulatory and employment functions are closely aligned so there are no gaps in the process that leads to a certification that a person is fit and proper.

Fitness and Propriety Behavioural conduct (such as harassment)

A frequently asked question is whether employment disciplinary sanctions for harassment are relevant in the assessment of a regulated person’s fitness and propriety. The received wisdom has been that in most cases it would not be relevant to the assessment criteria (honesty, integrity, reputation, competence, capability and financial soundness).

**Will this change under the new regime?**

This is an important question as it will now be the employer making the decision on fitness and propriety. Nothing substantial on fitness and propriety has changed but there is a shift in emphasis on personal accountability and a Senior Manager’s ability to manage the function and its people. It is not difficult to imagine a scenario where a Senior Manager has been accused on numerous occasions (or even a single occasion) of discrimination, harassment or bullying. The Senior Manager denies the allegations vehemently but the investigation finds otherwise, or the outcome is that whilst there will not be a finding of misconduct, additional training or behaviour modification will be required.

It would be almost inconceivable that this type of behaviour is not relevant to the honesty, integrity and reputation of the Senior Manager. It may also be relevant to competence and capability and the person’s ability to command respect and manage a function.

*Tullett Prebon v BCG Brokers* is an example where behaviour (concerns over the honesty of a witness in a team moves case) resulted in the regulator imposing a lifetime regulatory ban on Anthony Verrier. The regulator was influenced by comments made by the High Court: “I found that in his evidence Mr Verrier stuck to the truth where he was able to, but departed from it with equanimity and adroitness where the truth was inconvenient.”

Further down the regulatory chain, in the Certified Persons community, behavioural conduct (such as harassment) may be less relevant— but not always.

A related point is whether activity in a person’s private life is relevant to fitness and propriety. The regulators have said that the conduct rules do not apply in this area if they are unrelated to regulated activity. However, it could be relevant for an assessment of fitness and propriety.
Conduct rules and notification

The regulators are introducing a new Code of Conduct, which is loosely based on the old APER principles, but the way in which the rules are structured (in two tiers) and each regulator’s approach is different and, at this stage, looks more complicated. Different rules will apply to different categories so, for example, second tier rules apply only to Senior Managers. In addition to regulated individuals, the FCA is extending the application of its Code of Conduct to a potentially very wide population of employees – basically everyone other than ancillary staff who perform a role that is not specific to financial services (e.g., HR administrators and Facilities Management).

The thinking behind the extension to unregulated individuals is to bring about the culture change at all levels together with a deeper understanding of what is and is not acceptable behaviour.

Training programmes will need to be rolled out to all applicable staff, with more sophisticated training given to Senior Managers and some Certified Persons. HR will have a role to play in encouraging culture change by reinforcing the “good regulatory practice” elements in any training programmes.

Breaches or suspected breaches of the Code of Conduct by Senior Managers need to be notified to the regulators within seven business days. This is another red flag area as the timeframe within which to investigate and come to a preliminary conclusion is very short. It may well be that the initial report is categorised as “suspected” to buy more time to complete the regulatory/employment investigations. This is why it is essential for all the stakeholders (e.g., HR and Risk) not only to be aligned and working seamlessly but also to be supported by crisis management procedures which can “kick in” immediately.

For all other employees subject to the Code of Conduct, notification is made on a quarterly basis to the FCA (who will pass onto the PRA if relevant). This is somewhat surprising at first as you might expect some breaches to be notified, as is the case with Senior Managers, within seven business days. It is not entirely clear at this stage how this fits with a Senior Manager’s obligation to notify the Regulator of anything relating to the firm of which it would reasonably expect notice. But as discussed above, the new regulatory landscape turns Relevant Firms into mini regulators giving them the lion’s share of responsibility for the fitness and propriety of their workforce.

In this new world, Relevant Firms need to “sort it out” themselves, just touching base with the regulator with quarterly and annual returns. The Regulators in turn focus on the big issues with the Senior Managers who take responsibility.

A challenge for large organisations will be to ensure internal consistency of approach with breach of conduct reports. This could be done by using a special compliance unit staffed by a combination of HR and Risk, and to which all suspected breaches are referred, from which all investigations are initiated, and outcomes reported. A central point has the added advantages of being able to identify trends within and across business units, gaps in reporting lines, supervision and training. The unit can then report directly into the Senior Managers so appropriate action can be taken.
Role of HR

As traditional guardians of systems and processes, guidance and training for the entire lifecycle of an individual (whether regulated or not), HR will find themselves at the heart of the new regime and may well find a chair waiting for them at the board table, or as close advisers to the Senior Managers.

Their expertise in implementation of processes, and in embedding expected standards into objectives, training and appraisals will be invaluable to Senior Managers who will inevitably have to delegate operational matters to experts they can trust. An opportunity to align HR with the business and Risk at the highest levels is there to be taken.

*A Senior Manager regime made up of “Stepford types” will be detrimental to collective decision-making, with gaps emerging due to the “sameness” of vision and thinking.*
Diversity

Mandatory quotas and ‘all women’ shortlists have never gone down well in this country for a number of reasons, even though all the research demonstrates that diversity is a commercial imperative.

The new Senior Manager and Certification regime is crying out for diversity to be incorporated into the top two layers of management and governance.

And “diversity” in this context does not mean women – it covers the entire spectrum from personality types and background to gender and experience.

A Senior Manager regime made up of “Stepford types” will be detrimental to collective decision-making, with gaps emerging due to the “sameness” of vision and thinking.

It is only by incorporating multi-dimensional thinking that decision-making will be more rounded. The PRA picks up this point when it discusses whether or not those managing a firm are fit and proper. In its view, the management needs collectively to be equipped with a mix and balance of skills to understand and manage its business prudently.
The new regime is a whole new ball game, both conceptually and operationally, with a shift in emphasis in terms of personal and collective responsibility, as well as in who regulates. It is designed to address a specific problem:

– The Approved Persons Regime has created a largely illusory impression of regulatory control over individuals, while meaningful responsibilities were not in practice attributed to anyone. As a result, there was little realistic prospect of effective enforcement action, even in many of the most flagrant cases of failure.

These words are not ours but those of the Parliamentary Commission for Banking Standards (PCBS). Its recommendations have been wholeheartedly embraced by the regulators with the result that the new regime is not a tinkering exercise “on the rickety foundations of the Approved Persons regime” as the PCBS feared. It is a complete makeover.

There is much work to be done over the next two years by Relevant Firms in terms of bringing the governance and operational elements together, and acting as a single business rather than in silos.

Transparency and on-going accountability will be the new guiding principles. And for those who fail or fall short as regards regulatory activity, there will be a scary phoenix waiting for them in the wings.
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