

AFB RESPONSE TO HM TREASURY CALL FOR EVIDENCE – SENIOR MANAGERS & CERTIFICATION REGIME

Introduction

We welcome the publication of HM Treasury's Call for Evidence on the review of the Senior Managers & Certification Regime (SM&CR). We note that this review is taking place in the context of a renewed focus on the international competitiveness of the UK. This is a key topic for the members of the Association of Foreign Banks (AFB).

AFB represents non-UK headquartered banks operating in the UK. With around 170 members from across the world, we represent 75% of the UK's foreign banking market. Our members (operating via branches and subsidiaries) employ over 110,000 people across the UK.

AFB supports the principles and objectives which underpin the SM&CR, but there are some areas of the regime which we believe could be improved/modified without undermining the aims of the SM&CR. Our proposals would streamline procedures and reduce the compliance burden, thereby making the UK a more attractive and competitive market, and also help to improve the effectiveness of the regulators. Please see also our response to the PRA's/FCA's Discussion Paper 1/23.

We set out these areas in our responses to the questions below.

1. Has the SM&CR effectively delivered against its core objectives? For example, making it easier to hold individuals to account; or improving governance, behaviour and culture within firms.

Members have noted the following points:

- the SM&CR provides clarity on roles and responsibilities as it requires banks to think specifically about the activities they undertake, job descriptions, roles and responsibilities and the documenting within Statements of Responsibilities of who is responsible for what at a bank
- the SM&CR enhances the governance of banks as it encourages them to consider in depth and document their governance arrangements, for example via the Management Responsibilities Map
- the SM&CR and associated documentation (Management Responsibilities Map, Statement of Responsibilities etc.) can also be used by banks as part of their governance-related control environment

- there are benefits for banks in having a Management Responsibilities Map when dealing with regulators and internal/external auditors
- the SM&CR prompts Senior Management Functions (SMFs) to think about how much reliance they can place on staff when delegating tasks
- the SM&CR encourages SMFs to think about how to maintain oversight (and critically, to evidence this) in order to improve governance and record keeping practices overall
- the seriousness of individual accountability/the requirement to take reasonable steps has helped to “focus the mind” on ensuring that, as an individual, you take (and can prove that you have taken) steps that a regulator would have expected you to take, in the event that an issue arises. AFB member banks consider that the risk of enforcement action has improved culture and conduct as a whole

2. Do these core objectives remain the right aims for the UK?

AFB members take the view that the core objectives of the SM&CR continue to be appropriate for the UK.

3. Has the regime remained true to its original objectives or has the scope or use of the regime shifted over time?

The scope of the SM&CR has shifted over time, as it encompasses firms across the industry rather than only banks/insurers. The expansion of the regime to solo-regulated firms in 2018 was introduced in a proportionate way.

Further changes have been made to take account of the implementation of regulations on climate risk management, algorithms, digital assets and operational resilience. In particular, the regulators have increased the scope of the regime by adding ‘prescribed responsibilities’ and by mandating the allocation of ‘other responsibilities’.

Although AFB members understand that responsibilities will evolve as the regulatory system develops, it should be recognised that such responsibilities will generally be inherent in the SMFs outlined by the regulators.

There is an ongoing need for careful consideration of whether (after consultation with industry) to introduce new responsibilities. The introduction of new responsibilities could undermine the concept of inherent responsibilities of the SMFs and reduce the flexibility of the regime to take account of a changing regulatory landscape. The approach of adding senior management responsibilities also increases the perception (particularly internationally) that the UK regulatory environment is overly burdensome/onerous. This in turn may undermine the competitiveness of the UK market internationally.

4. The government would be interested in respondents' reflections on their experience of the SM&CR, now that it has been in place for some years.

Please see our response to questions 1 and 3.

We also agree with the points made in the response to this question by TheCityUK with respect to: (a) the non-alignment of the definitions of employee in the regime with the definition in the general law; (b) the inconsistency in the approach taken by different banks/firms as to what is a breach of conduct rule; and (c) the operation of the 12-week rule.

5. What impact does the SM&CR have on the UK's international competitiveness? Are there options for reform that could improve the UK's competitiveness?

As mentioned above, AFB notes the benefits of the SM&CR as a framework for governance, accountability, culture and conduct. However, in the context of the UK's international competitiveness, AFB members face a specific challenge, as most of our members are headquartered in jurisdictions where the regulators and senior representatives of the bank are unfamiliar with the SM&CR approach.

AFB members believe that the following changes would have a positive impact on the UK's attractiveness as a venue for non-UK banks:

- **Application process for SMFs:** As has been noted in the feedback provided to the regulators by industry, the current process is lengthy and can be confusing. The regulators rightly promote good governance but the extended delays in dealing with applications runs counter to this. In general, the process could be streamlined and the length of time it takes to receive a decision should be quicker and at least in line with published service standards by the regulators. (Please see also our response to question 8, which outlines areas for reform.)
- **Introduce mutual recognition/equivalence/deference:** Where an individual seeking to be an SMF has already gone through an approval process in the UK or in an equivalent jurisdiction, they should not be required to go through the full application/approval process. This approach (with respect to another jurisdiction) could be taken in circumstances where the other jurisdiction grants a reciprocal exemption on the basis of an agreement on the exchange of information between the UK and that jurisdiction. The introduction of such a modified process would (in the medium and long term) reduce the time spent on the approvals process by banks and regulators without undermining the aim of reducing the level of risk to the financial services industry.
- **Allow flexibility in the operation of the 12-week rule:** Allow the period to be extended by written application in order to accommodate any additional time required. A fixed time limit does not work in all cases and members consider that 12 weeks is not long enough to allow banks enough time to fill vacancies or to take account for cover on an interim basis. As a starting point, we propose the 12-week rule is extended to 24 weeks. The guidance with

respect to the rule should also be expanded to make it clear that it applies to temporary absences and the time period following which a new SMF joins a firm before they receive approval as well as temporary appointments. In this context it should be noted that any individual conducting the relevant SMF role, will at all times be subject to personal regulatory duties under the Individual Conduct Rules (unlike the position when the 12-week rule was introduced).

- **Prescribed responsibility (ff):** AFB members have highlighted a concern about the prescribed responsibility for all regulatory requirements relevant to the firm (prescribed responsibility (ff), applicable to overseas firms). The purpose of this prescribed responsibility is unclear, as all SMFs have regulatory requirements in their respective areas. The general responsibility appears unnecessary given the objective of the SM&CR is individual accountability. AFB would welcome the PRA/FCA either providing guidance on whether this prescribed responsibility (ff) takes precedence over individual accountability or removing it from the regime.
- **Cross-border scope of the Certification Regime:** The Certification Regime has a cross-border impact as it also applies to non-UK domiciled individuals conducting business with any UK customers. This makes sense from a consumer protection perspective where the non-UK person is engaging with retail clients. However, it is disproportionate where that non-UK person is conducting MiFID investment business with a non-retail client i.e. a professional client or eligible counterparty. We propose a change to the Certification Regime so that individuals engaging with UK professional clients and eligible counterparties from outside the UK do not need to be captured by the regime. The extraterritorial aspects of the SM&CR present a significant challenge for non-UK banks in the UK (or non-UK banks considering entering the UK market) and therefore should be risk based and proportionate.
- **Certification - annual fitness and propriety assessments:** AFB members commented that the requirement for banks to complete an annual reassessment of certification staff's fitness and propriety can be particularly onerous for smaller banks. We would propose that the requirement for an annual reassessment is changed to a reassessment every two or three years. If banks are subject to the requirement to conduct a reassessment of fitness and propriety where it becomes aware of matters that could call into question the individual's fitness and propriety (including suspected misconduct) then this should ensure that the purpose of the rule is met while minimising the administration process. We also expect that a more detailed reassessment of fitness and propriety would be undertaken by banks if it occurs less frequently.
- **COCON guidance on non-financial misconduct:** Whilst the FCA has publicly expressed a view that non-financial misconduct may amount to a breach of the Individual Conduct Rules, the current guidance set out in COCON does not reflect this. In particular, the examples listed in COCON 4 as types of conduct that amount to a breach of the Conduct Rules does not

include any examples of non-financial misconduct. Whilst we appreciate that this guidance provides a non-exhaustive list, as a matter of fairness to firms and employees, we would request that this list is updated to include examples of non-financial misconduct if the FCA wishes for non-financial misconduct to be treated as a breach of the Conduct Rules.

In addition, we also propose that the following two changes are made to COCON:

- the examples of misconduct listed in COCON 4 should be converted into Evidential Rules so that they have legal effect and are therefore treated with the same authority as they previously had under the Statements of Principle for Approved Persons. This would provide a clear standard to assess whether a not a Conduct Rule has been breached
 - COCON (specifically COCON 1.1.7A) currently applies to a wider range of activities at banks than other regulated firms. We would propose that this is updated so that the application of the Conduct Rules is consistent across all regulated firms.
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- **Rationalisation of regulatory references requirements:** Under the current rules, banks/firms are required to take reasonable steps to obtain a regulatory reference covering the last six years of employment history for individuals being recruited externally or moving internally into SMF positions or certified functions. Banks/firms have a corresponding duty to provide a reference to another bank/firm on request. The duty to request a regulatory reference also extends to employers not in scope of the SM&CR requirements i.e. those outside the territorial scope of the UK regulators and/or outside the financial services industry. AFB members propose that the requirement to request regulatory references from employers which are not in scope of the SM&CR is removed. Typically these employers do not hold records aligned to the request set out in the template regulatory reference request and their obligations under employment law may prevent them from providing information to the extent set out in the request. It is generally the case that such requests do not add value to the process, supplement the bank's due diligence in a meaningful way or meet the objectives of the regulatory reference process. The adoption of this proposal would reduce time lags in the recruitment process for staff outside the financial services sector and/or from outside the UK and remove a disincentive for banks to engage in a broader recruitment process. It would reduce the barriers to entry for international candidates and those from outside the financial services industry and therefore increase the attractiveness of the UK financial services industry.
 - **Removal of the FCA Directory Registration Requirement for all Certified Persons (CPs):** When the SM&CR was introduced, CPs were not included in the FCA register but SMFs were. In 2018 the FCA introduced a requirement for all CPs to be included in the public register stating that this was needed for consumer protection. Banks must keep the register up to date at all times, with changes to the register made within seven days. AFB members do not

believe that there is any value in including all CPs in the Directory as the majority of CPs deal with professional clients and eligible counterparties. AFB members propose that the Directory only includes details of CPs who are dealing directly with retail customers. This would fulfil the FCA's aim of furthering consumer protection and reduce the administrative burden on banks dealing primarily or exclusively with wholesale customers.

- **Reduction in number of Certified Persons:** A further proposal which would assist non-UK banks (with branches in the UK) would be for the regulators to provide additional guidance on which individuals should be certified staff (also including the definition of material risk takers) and to reduce the scope of individuals who fall within the definition of CPs. The current lack of guidance means that many branches of non-UK banks take a precautionary approach and certify a broader group of employees than is necessary. AFB members take the view that in most cases only the head of a particular business or a desk head should be certified (or captured as a material risk taker) as the strategy of a bank is typically determined at head office and executed by the branch. Accordingly, for branches it is not necessary for a broader group of client facing roles based in the UK to be certified. Reducing the number of certified persons (including those who are required to be certified as they are material risk takers) would increase the attractiveness of the UK as a venue for the expansion of business of non-UK banks.

6. Are there examples of other regimes that the government could learn from?

We note that a number of the accountability regimes which are being developed in other jurisdictions, including Australia, Singapore, Hong Kong and Ireland have taken a lead from the UK and the SM&CR.

Subject to our comments in response to question 7, AFB members believe that the UK Government and regulators should maintain this position/continue its development of the regime and adopt changes/improvements that we have outlined in this response.

7. How does the level of detail, sanctions and time devoted to the UK's SMCR regime compare with that in other significant financial centres?

AFB members report that in other significant financial centres aspects of the accountability framework in place (e.g. seeking pre-approval for SMFs) require less time and resources than in the UK. The approach taken by these (overseas) regulators is to put more emphasis on banks/firms to manage due diligence and the ongoing fitness and propriety of individuals undertaking more senior regulated roles and activities (rather than seeking to impose accountability on more junior staff members). This in turn allows these regulators to use their resources more effectively using a risk-based approach which ultimately reduces the barriers to entry to the financial services industry in those centres. This boosts their competitive position. The proposals we are making in this response are designed to align the UK regime with the overall approach taken in other jurisdictions.

8. Are there specific areas of the SM&CR that respondents have concerns about or which they believe are perceived as a deterrent to firms or individuals locating in the UK? If so, what potential solutions should be considered to address these? Respondents should provide as much detail as possible to help build the fullest picture of any issues.

AFB members note that there has been an increase in SM&CR applications received by the UK regulators (the FCA in particular). However, this has subsequently led to an increase in processing times, which can deter banks or individuals from recruiting from/locating in the UK. AFB members report that the SM&CR process is generally perceived in head offices as being slow (as well as being a more onerous regime than others). Overall, this acts as disincentive for well qualified senior candidates to move to the UK and the delay creates uncertainty which in particular affects candidates moving with families/changing schools etc. It also means that the individual taking on the interim responsibility (such as the CEO or another appropriate SMF) has to take on additional responsibility for a long period which could lead to risk and control issues as they are likely to be less able to oversee appropriately the additional functions allocated to them on an interim basis.

AFB welcomes the work that the UK regulators are already undertaking to reduce the backlog of authorisations and to improve efficiency. Alongside this work, we believe the backlog and processing times could be further reduced by the introduction of proportionality in either or both of the following ways:

- Certain categories of SMF applications could be exempt from the requirement to receive approval prior to beginning an SMF role. Banks would still apply for approval but would not be required to wait for that approval from the regulators before the SMF starts his/her role and assumes their formal responsibilities. We would suggest exemptions in cases where SMFs have previously been approved by one or both of the regulators, where the new role is not materially different to the role previously approved and where there have been no prior concerns in relation to their fitness and propriety. Due diligence would still be undertaken by the firm, and the application to the regulator (including the supporting documentation) would still be submitted. However, the individual in question would be able to undertake the formal responsibilities of the role at submission date. This would not preclude the regulators from reviewing the application, interviewing the candidate, or requesting further information before making a determination on the fitness and propriety of the individual. Another option would be to allow an individual, who is not already an SMF, to work under the supervision of another senior manager within the bank until they have received approval from the regulators. The contract would specify that taking on the role without such supervision is subject to the approval being granted by the FCA/PRA. A modification of the process would enable an appropriate investigation to take place within a time frame determined by the circumstances of the individual application and avoid unnecessary disruption to the business of the regulated firm. This pragmatic approach would increase the attractiveness of the UK as a place for senior executives from non-UK banks to work.

- Additionality, or as an alternative, proportionality could be applied in a way similar to that applied to notified Non-Executive Directors, where a sub-set of specific SMF categories is deemed 'lower risk' would not require approval prior to undertaking their role. SMFs in the 'lower risk' category would be able to undertake their role immediately. The regulator would retain the right to interview the candidate, request further information and decide on the fitness and propriety of the individual. Other categories of SMF (for example, Chief Executive Officer, Compliance Function, Money Laundering Reporting Officer and Chief Risk Officer) would go through the same process as currently.

The above proposals would help the regulators to meet the challenges that they are facing (and are likely to continue to face given the number of applications) in meeting the 90-day decision time limit. Overall, this would improve the attractiveness of the UK as a place for financial services business, as the UK regulators would be perceived as taking a risk-based approach in its operation of the SM&CR.

9. Is the current scope of the SM&CR correct to achieve the aims of the regime? Are there opportunities to remove certain low risk activities or firms from its scope?

As described in our answers above (and in particular our response to question 8), we do consider that it is possible to reduce the scope and administrative burden of SM&CR, whilst maintaining the aims of the regime.

10. Are there "lessons learned" that government should consider as part of any future decisions on potential changes to the scope of the regime to ensure a smooth rollout to firms or parts of the financial services sector?

AFB members note that previous changes, including the extension to solo-regulated firms, were introduced smoothly after consultation with the industry and sufficient time was given for implementation. To the extent that any changes are made as part of this review, we would encourage the Government to follow a similar approach.

11. Any other comments the government or regulators would benefit from receiving?

AFB members ask that the Government/regulators provide guidance in the following areas:

- how banks/firms should conduct the reviews of all SMFs and Certified Persons. This guidance should cover, for example, what tests to apply and by whom, and which records to keep and for how long
- what constitutes reasonable steps for banks/firms as they conduct due diligence

AFB members would also ask for the regulators to consider publishing, on a regular basis, the details (anonymised as necessary) of situations where they have refused approval to an SMF applicant (including where those applications have been withdrawn by the bank where the

regulators have indicated that they are minded to refuse the application). This would provide useful insight for banks as they draft SMF applications.

Further, AFB members note that there is an overlap between the concerns raised in relation to the SM&CR and those raised about the UK remuneration regime with respect to deferrals. Members report that the deferral period for remuneration was cited as a disincentive for senior staff to re-locate to the UK from overseas, to re-locate to the financial services sector from other sectors, or to seek promotion to an SMF position (as this would mean a longer deferral period than other roles).

AFB members understand that the PRA considers deferral periods to be a core element of the remuneration framework. AFB members note that the PRA is continuing to require a deferral period for a minimum of four years, and for individuals performing an executive PRA SMF in regulated firms, up to seven years. Whilst AFB members understand the need for deferral periods, members believe that the PRA should extend the scope of its review of the SM&CR and introduce changes to deferral period requirements so that they can align with home country regulatory requirements. As it stands, non-UK banks in the UK are typically adopting more stringent, longer deferral periods than in their home jurisdictions, which is a disincentive to senior staff moving to the UK. AFB members support the proposed removal of the bonus cap, and extending the scope of the review to deferral periods would further increase the international competitiveness of the UK.

We hope that this response will assist HM Treasury as it considers reforms to the regime in order to improve the UK's regulatory environment and its attractiveness as a place for financial services business.

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