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SMCR: EVOLUTION AND REFORM

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Introduction

Governance and culture at UK banks has been the subject of much focus and scrutiny since the financial crisis. It is now over three years since UK banks implemented new rules comprising the Senior Managers and Certification Regime. These rules were met with some trepidation not only on the part of the individuals identified as senior managers but across the banking industry as a whole. All were concerned to understand what the practical impact of the new regime would be.

The aim of this report is to discover what change has occurred as a result of SMCR, both in individuals and at firms (if any).

This report is the culmination of over a year spent collecting data and speaking to senior managers and control functions about their experiences and opinions on what the impact of SMCR has been in their firms. It is the most in-depth study conducted to date of the practical implications of the SMCR, benefiting from the responses of more than 25 banking institutions, hearing directly from almost 60 senior managers and drawing on nearly 2000 data points.

Our key finding is that industry respondents regard the introduction of the SMCR regime as a positive development which has led to improvements in behaviours and processes within firms. The output of this report evidences an industry which has shown serious commitment to change, embraced the spirit of the new rules and now has a population of senior managers who accept accountability with respect to their role, as well as showing a deep commitment to maintaining the highest standards of conduct in their organisations.

The data gathered also allows us to make recommendations on where further improvements could be made. With this aim, we have highlighted where the report's findings have led us to propose changes to the regime or general practice and we hope that these are proposals which are considered and acted on in the future. We also highlight where emerging trends are developing which are worth tracking (for example around the impact of regulatory references) and where some respondents express concern over the potential direction of travel.

Executive summary



WHAT WE DID

In preparation for this report, we asked questions at banking institutions of (i) the senior individuals (generally senior managers), (ii) senior governance functions (“governance functions”) and (iii) those performing controlled functions (“controlled functions”). Those in controlled functions include individuals who have been involved in the implementation and/or ongoing compliance with the SMCR at their firms. Those who we classified as governance functions may have either been involved in SMCR compliance and/or coordinated their firm’s response to our questionnaire. We also ran roundtable discussions with respondents to discuss in more depth some of the key messages which developed following our review of the questionnaire responses.



WHICH KEY THEMES EMERGED?

Change

We asked a series of questions to determine whether change had occurred as a result of the SMCR (including perceived change as well as evidence of real change). Overwhelmingly there is a perception within firms that there has been meaningful change. There was also evidence of real change taking place, with particular emphasis on a change in culture and behaviours. In addition, respondents reported that the implementation of the SMCR had brought the added benefit of requiring firms to definitively clarify the roles and responsibilities of senior managers. However, there was some input that suggested that the SMCR had led to too much complexity and a focus on recording evidence of decisions and actions. The report also concludes that the industry has become more risk averse, although there is a debate whether this amounts to a real change in risk appetite or alternatively more consideration of risk in decision making.

Processes

From our findings it is clear that there was significant procedural change in firms, particularly at the implementation stage of the SMCR but also for ongoing compliance. For senior managers, joining and leaving firms has now become more burdensome and senior managers largely report a greater consideration of the impact of SMCR rules on their day to day working practices and future employment. A majority of senior managers reported that they did not know how they would access their records after departure from their firm if they were to be subject to a regulatory investigation.

Decision making

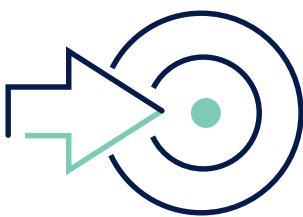
A common thread of feedback from respondents was that decision making processes had changed and there was more focus on the governance of decisions. Many reported that the use of committees had been clarified, often with terms of reference for such forums being amended.

Fitness and propriety

Again, significant change was reported by respondents in light of the new fitness and propriety requirements. There was clear evidence that firms were identifying breaches of the conduct rules although methods for doing so were not uniform across different firms. Again, tangible effects of the certification rules were reported by respondents, including in some cases difficulty in identifying the population of certified staff within a firm.

Key documents

We asked respondents about statements of responsibility, management responsibilities maps, senior manager handovers and regulatory references. Responses showed a real commitment to the production of these documents. The practical impact of regulatory references – particularly by hiring firms – was discussed at great lengths by respondents, with some reporting that firms will now reject a candidate on the basis of any negative indication – no matter how minor – leading to a zero tolerance, “no second chances” approach.



WHAT ARE THE RECOMMENDATIONS OF THE REPORT?

Following a review of our findings, and with the aim of improving the functioning of the regime, we have drawn out a number of areas where there is potential for positive change. We have made a series of recommendations which should be of note to both regulators and industry. These include suggesting:

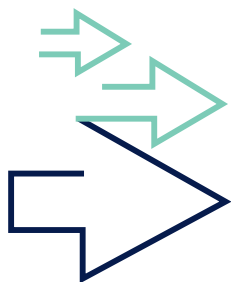
1. a proportionate approach to the application of SMCR rules to banks so that smaller firms could benefit from a lighter touch approach if they were to be classified as a ‘core’ firm, in the same way as FCA solo authorised firms
2. the reduction of some of the administrative aspects of the regime, such as decreasing the frequency with which management responsibility maps are updated
3. the implementation of a new regulatory rule providing senior managers with a right of access to their records post-termination of employment (rather than leaving this to the internal policies of a firm)
4. revisiting the regulatory reference template so that the ‘catch all’ question is removed to provide greater certainty for firms on what they should and should not include
5. greater clarity of regulatory guidance for firms on the treatment of senior managers under internal investigation
6. an amendment to the criteria for defining certified staff under the SMCR (with particular consideration of the criteria for material risk takers, which can often lead to a population of certified staff which is illogical and confused)

-
7. further guidance on what should amount to reasonable steps for senior managers in the context of the duty of responsibility
 8. guidance on the scope of conduct that will constitute a breach of the conduct rules.

We expect that guidance sought under (7) and (8) above is unlikely to be provided by the regulators and may be an action for industry to pursue itself.

Generally, the output of this report evidences an industry which has exhibited serious commitment to change, embraced the spirit of the new rules and now has a population of senior managers that have a sound understanding of what it means to be a senior manager operating in the UK. The good news – and a key takeaway - is that our report reflects an industry that is led by individuals who are willing to accept full accountability with respect to their role, as well as a deep commitment to maintaining the highest standards of conduct in their organisations. With such positive progress however, we hope we have highlighted where future possible improvements may lie.

Our recommendations



ACTIONS FROM THE REGULATOR OR OTHER GOVERNMENT BODY

Recommendation 1:

The introduction of proportionality in relation to the application of the SMCR's requirements insofar as they apply to banking institutions

Currently, all UK-based banking institutions must comply with the same rules in relation to the SMCR.

Our recommendation would involve the recategorisation of smaller banks and building societies as akin to FCA solo-regulated firms with “core” firm classification. Such recategorisation would serve to alleviate some of the disproportionate regulatory burden currently falling on those smaller institutions in contrast to the present “one size fits all” approach. Alternatively, tolerances or dispensations should be introduced in respect of specific requirements based upon the size and complexity of the relevant banking institution’s business.

Recommendation 2:

The reduction of particular aspects of the SMCR's administrative burden

Currently banking institutions must ensure that certain administrative requirements, such as Management Responsibility Maps (“MRMs”), are continually up to date.

We would propose the removal of some of these administrative burdens, for example, replacing the obligation to continuously update MRMs with an annual or semi-annual obligation to update.

Recommendation 3:

Creation of a senior managers' right of access to records

Currently, senior managers are subject to firms’ own internal policies and procedures when it comes to how they may access their records in the event of a regulatory investigation into their behaviour. Such internal policies and procedures could themselves change after that termination of appointment or employment of a senior manager, which may cause further confusion or frustration.

We propose the implementation of a new regulatory rule providing senior managers with a right of access to their records post termination of employment (rather than leaving this to the internal policies of a firm).

Recommendation 4:**Amendment to the regulatory references form to remove Question G**

Question G of the template regulatory reference form relates to the awareness of “any other information that we reasonably consider to be relevant to your assessment”. This has caused tension between rights and obligations under employment law and the obligation on firms to complete the regulatory reference to the best of their knowledge.

We propose that this question is either deleted or amended to provide more consistency and comfort to firms that it is not a ‘catch all’ question.

Recommendation 5:**Review of regulatory guidance on the treatment of senior managers under investigation**

This regulatory guidance is currently conflicting and may lead to uncertainty and inconsistencies of approach across firms.

We suggest revisiting the guidance from the UK regulator on what should and should not happen as a result of a senior manager being put under investigation.

Recommendation 6:**Amendment of the criteria for defining certified staff**

Certified staff are currently defined according to a large set of criteria.

Our proposal would involve narrowing the criteria that defines the population of certified staff in order to reduce that population – thus ensuring that it does not capture junior staff within organisations whose roles do not justify such enhanced supervision, and instead focusing attention on those whose roles warrant enhanced supervision and scrutiny.

**ACTIONS FROM INDUSTRY****Recommendation 7:****Guidance to be provided on what should amount to reasonable steps**

In the context of the duty of responsibility introduced for senior managers, it would be useful to have industry guidance to help firms and senior managers with their expectations in relation to reasonable steps and the type of “reasonable steps framework” which firms should have in place.

Recommendation 8:**Further guidance on the approach to conduct rule breaches**

This would help to ensure consistency of approach across firms given the weight which firms place on regulatory references and the disclosure of any conduct rule breaches which they may receive notice about.

Change in culture, behaviour and attitudes towards risk

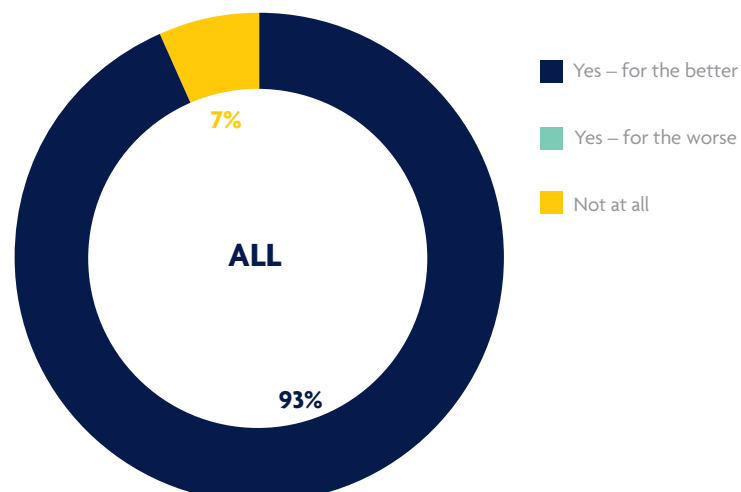
Our report shows that since the introduction of the SMCR there has been a meaningful and tangible change in culture, behaviour and attitudes towards risk within firms. For senior managers, the evidence shows that the SMCR has focused minds, with a clear emphasis on what each person is individually responsible for, and how they could be held accountable. However, there is rather less evidence of such a tangible impact throughout the rest of a firm. Some respondents were also critical, expressing the view that the changes have created too much complexity and engendered a focus on recording decisions and actions, rather than looking at culture more holistically.

MEANINGFUL CHANGE

We asked whether the new SMCR rules had brought about a meaningful change in behaviours in the industry.

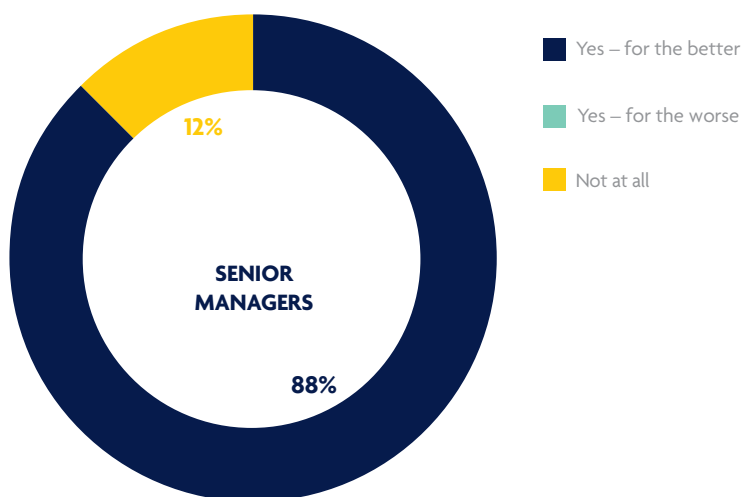
Overall there was strong agreement that the SMCR has brought about meaningful change for the better. 93 per cent of all respondents agreed with this, and the remaining seven per cent felt that there had been no meaningful change. No respondents felt that there had been a change for the worse in the industry as a result of SMCR.

All: Do you think the SMCR has brought about a meaningful change in behaviours in the industry?



There was unanimity amongst those in governance and control functions that the SMCR has brought about meaningful change in behaviours in the industry, and that those changes had been for the better. The view amongst senior managers was likewise quite clear.

Senior managers: Do you think the SMCR has brought about a meaningful change in behaviours in the industry?



Respondents commented:

- (a) “It has changed behaviours in both directions. It has increased the focus on front line responsibility for risk and has driven a deeper understanding of the business by the most senior people. It has however driven additional (and some may say unnecessary) complexity and to some extent encouraged silo thinking.”
- (b) “It has increased awareness and clarity on individual accountability, leading to more scrutiny, review and challenge of evidence supporting decisions. Individuals are clearer on what they are accountable for and how to evidence that they are [discharging] their responsibilities effectively. This focuses individuals on what really matters.”
- (c) “...senior managers are now more focused on doing the right thing, being able to evidence that they are doing the right thing, and are more meaningfully aware of what they are accountable for.”
- (d) “Greater awareness of individual responsibilities and the capacity to evidence reasonable steps taken to discharge these.”

Most senior managers likewise agreed (88 per cent of those surveyed), but others were not so convinced; 12 per cent of the senior managers who responded felt that there had not been any meaningful change. However, none felt the impact had been negative.

Some respondents reported that real change has been seen throughout the business. One controlled function respondent indicated that at the firm and governance level, the requirements around Statements of Responsibilities (“SoRs”), MRMs and “reasonable steps” (in the context of senior managers fulfilling their duty of responsibility) have been drivers for change.

At the certified person level, the annual certification requirements have driven real focus by managers certifying staff, and an increased mindfulness of behaviour unbecoming or falling below expectations. We will come back to this topic later on in the report. On the other hand, one respondent reported that at the level below senior managers and certified persons, although most of such employees were now bound by the Conduct Rules, there has been less impact than perhaps public policy would have sought.

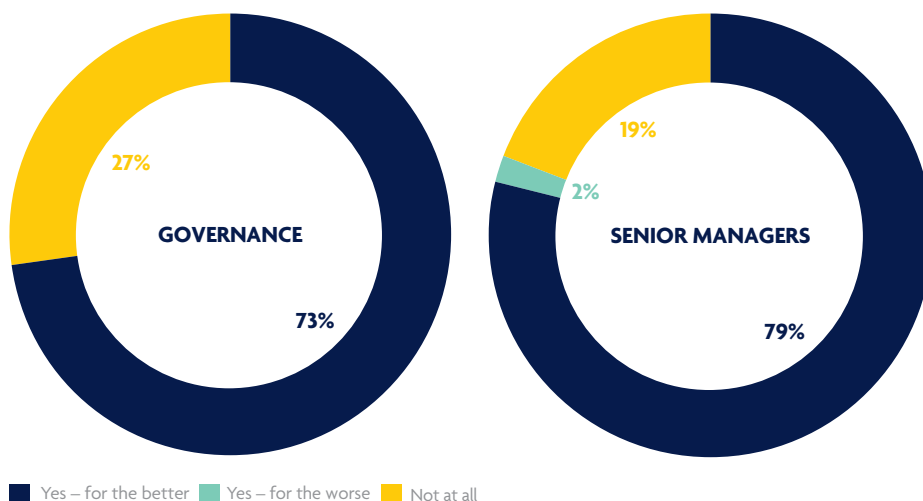
Those who perform a second line of defence or HR function also noted that the SMCR formalises what was already in place. The stick rather than the carrot of the SMCR (i.e. potential enforcement action against a senior manager) has served to focus minds, although some noted that there have been unintended consequences around the increased level of bureaucracy.

There were some reports that the SMCR has increased transparency by clarifying who is responsible and what they are responsible for, while helping to make it clear where “responsibilities begin and end”.

CULTURE

The SMCR has been lauded by some as the dawn of a new culture within financial services. The aim of the regime is to instil a culture in banks that is capable of regaining the public trust and demonstrating that individuals are being publicly held to account (thus avoiding a repeat of the negative headlines around failed bank executives not facing appropriate consequences for their actions).

Governance and senior managers: Has the SMCR changed the culture at your firm?



From our review, the cultural impact of the SMCR is generally perceived to be very positive. 73 per cent of respondents working in governance functions consider that the SMCR has changed culture at their firm for the better. Comments included that there was now a greater focus on governance and that it had also focused attention on responsibilities.

One interesting observation from one of the 73 per cent of respondents who felt culture had changed for the better was that there was “some detraction at first given that certified persons are no longer registered with the FCA”. However, “the re-emergence of the financial services register for certified persons, together with the extension of the SMCR to other financial services, should close this perception gap”.

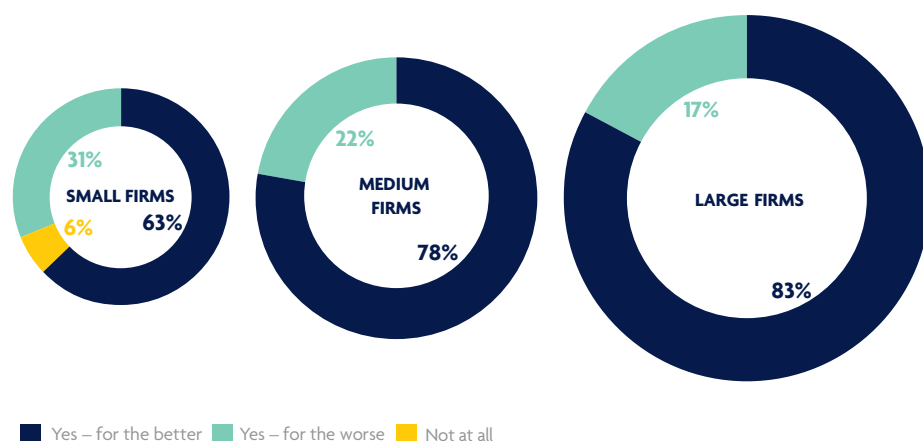
The remaining 27 per cent of respondents all considered that their firm's culture remained unchanged, but this was generally tempered by the comment that the principles behind the SMCR were already embedded in the firm's culture. For example, one respondent said “culture was already well established and SMCR has not impacted upon this”. Another observed that their firm's culture programme was already in flight pre-SMCR but that the SMCR had reinforced that existing programme. No respondents performing governance functions considered that their firm's culture had changed for the worse.

Senior managers are even more positive, with 79 per cent recognising a positive change in culture. One commented that the SMCR had driven better accountability while another indicated that it had changed the rigour around documenting decisions, although it had not fundamentally altered what was already a positive culture in that firm. 19 per cent considered culture had not changed either way, but two per cent (a single respondent) considered that there has been a negative impact on culture as a result of the SMCR.

This question was not addressed to those performing controlled functions but their views in relation to changes in behaviour (discussed further below) address a similar issue.

Perceptions of positive cultural change were generally greater at the larger firms. 83 per cent of respondents from large firms (firms with a headcount of over 5,000) reported a cultural change for the better as a result of the SMCR, as compared to 63 per cent of respondents from small firms (with a headcount of 500 or less) and 78 per cent from medium firms (with a headcount of between 500 and 5,000).

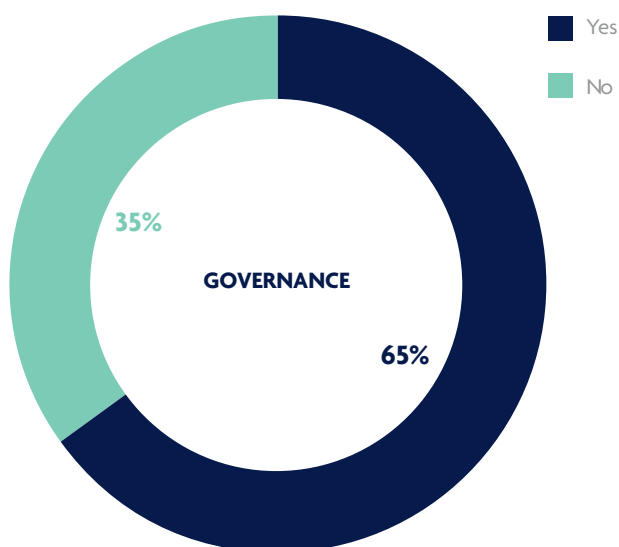
All: Has SMCR changed the culture at your firm?



RISK AVERSION

Perhaps a more telling metric is whether respondents consider that there is now more risk aversion in the industry since the SMCR was implemented.

Governance: Do you think there is more risk aversion in the industry since the SMCR was implemented?



65 per cent of those in governance functions within firms consider that there is now more risk aversion in the industry as a result of the SMCR. One respondent commented that “there certainly feels like less appetite to push boundaries or risk tolerances”. Another considered that there “is more focus on whether risks should be avoided to begin with rather than mitigated. Decision making, and recording those decisions is key”.

Some respondents commented that this may reflect more consideration of risks, rather than risk aversion per se. Others reported that there is more consideration of whether risks should be avoided rather than mitigated, and that decisions concerning risks are being heavily documented and recorded. Other respondents reported that there is more risk aversion insofar as people are more conscious of potential risks, escalation channels and documentation requirements.

Interestingly, one comment that was frequently repeated was that there is now more focus on what is reasonable from a risk perspective. Some respondents reported differing views. Indeed, some noted that there is divergence in respect of what amounts to reasonable risk in the industry.

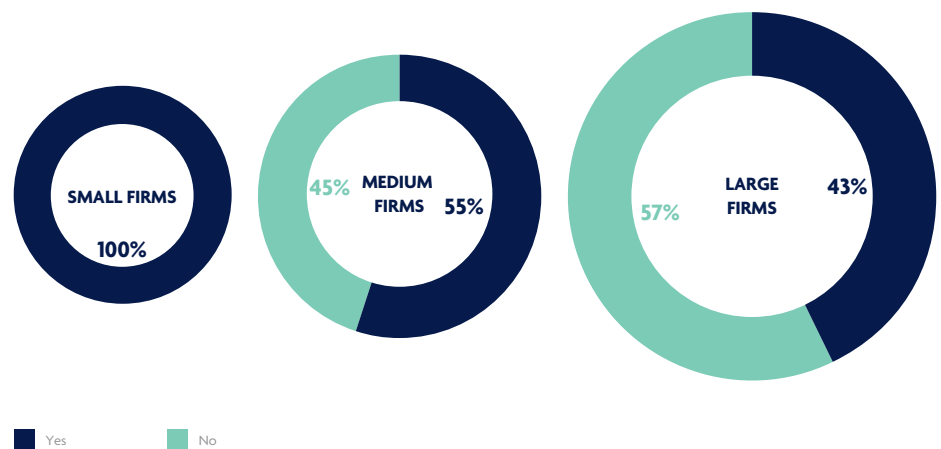
Some also noted that any change in risk appetite may not be directly attributable to the SMCR, which came about at a time when there was already a more general recalibration and reconsideration of risk appetite underway. This recalibration can also be attributed to other factors including capital and liquidity, governance, remuneration and market conditions, a combination of which may have been more significant than the SMCR itself.

a “...more risk awareness, rather than risk aversion”

b “...greater personal awareness has added another dimension to consideration of risk”

Interestingly, smaller firms appear to have observed the greatest increase in risk aversion compared to larger ones. All respondents from smaller firms felt that there was greater risk aversion following the SMCR, compared to only 55 per cent of respondents from medium-sized firms and 43 per cent of respondents from large firms.

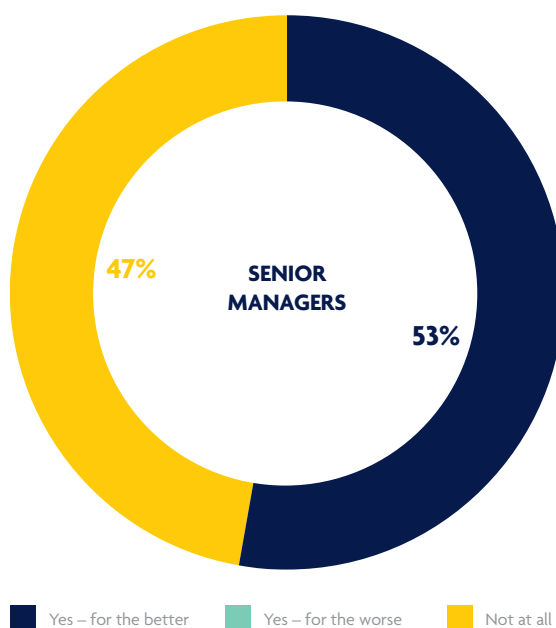
Do you think there is more risk aversion in the industry since the SMCR was implemented?



INDIVIDUAL BEHAVIOUR

The results and commentary above concerning changing behaviour address whether the SMCR has brought about a change in behaviours in firms from the perspective of those in governance and controlled functions. However, when senior managers were asked whether the SMCR has in fact changed their own behaviour, the results were quite surprising.

Senior managers: Has the SMCR changed your behaviour?



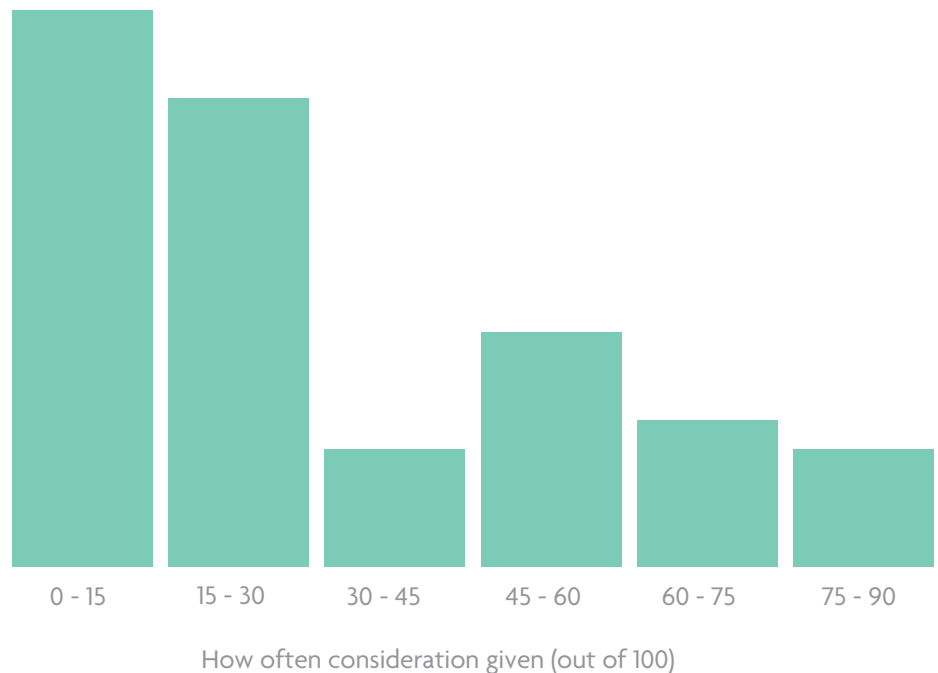
53 per cent of senior manager respondents said it had (for the better), while 47 per cent said it had not changed their behaviour either way.

Senior managers reported that there is now a greater focus on documenting certain matters and ensuring the firm is compliant with regulatory expectations. Many respondents reported that they previously behaved in the right manner but that they now have more evidence to demonstrate this.

A question this raises is whether this is an optimal use of resource and driving incremental value. This is probably the biggest criticism from senior managers: they have had to undertake more note-taking and recording of decisions (which is also reflected in some of the results on decision-making set out below). It could be suggested that real change in behaviour is not evidenced as widely as perhaps the intention of the regime had originally hoped.

Senior managers were also asked how often they considered what regulatory consequences could arise from the various rules associated with the SMCR. We received a very wide range of responses across a 0-100 range. The mean average reported by senior manager respondents was 28 out of 100.

Senior managers: How often do you consider what regulatory consequences could arise from the SMCR rules?



One respondent commented:

“it is always in the back of [my] mind but [I’m] not overly concerned since generally I feel the business is well managed and controlled”.

In contrast, a more critical view of the SMCR was expressed by one senior manager who said that:

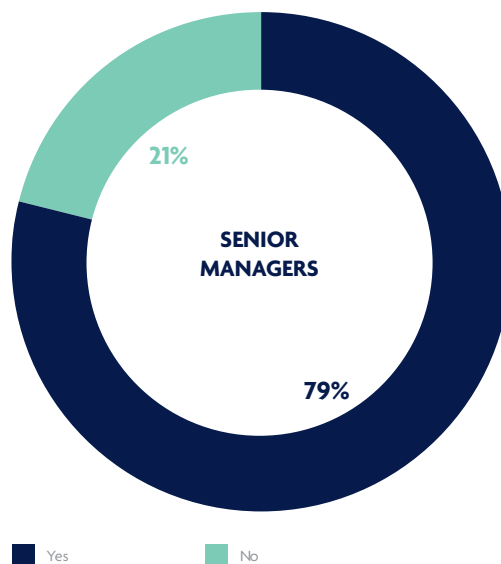
“I am concerned that the regime drives a behaviour of trying to justify that things are ok rather than managing them to be ok”.

Those who work in governance functions in banks were more affirmative in their view that the SMCR has changed senior managers’ behaviour for the better. 88 per cent of those respondents believe that the SMCR has led to improvements in their senior managers’ behaviour. Some reported more rigour being applied in relation to determining what constitutes reasonable steps. Another respondent said it had caused their senior managers to reflect on what accountability and responsibility mean in “word and deed”.

Delegation and supervision are much more carefully considered, as is whether it is reasonable and right to delegate parts of their responsibilities in the circumstances. Another observation was that the SMCR had reinforced existing culture and instilled greater discipline among senior managers. One respondent recorded that in group structures, particularly with overseas head offices, there was renewed focus on the boundaries of the UK entity's operations and its senior managers. All of this leads to general support for the premise that the SMCR has provided a clearer identification of who does what.

Senior managers were also asked whether all of their responsibilities (including their Prescribed Responsibilities) were clearer now than prior to the implementation of the SMCR.

Senior managers: Are all your responsibilities (including your Prescribed Responsibilities) clearer now than prior to the implementation of the SMCR?

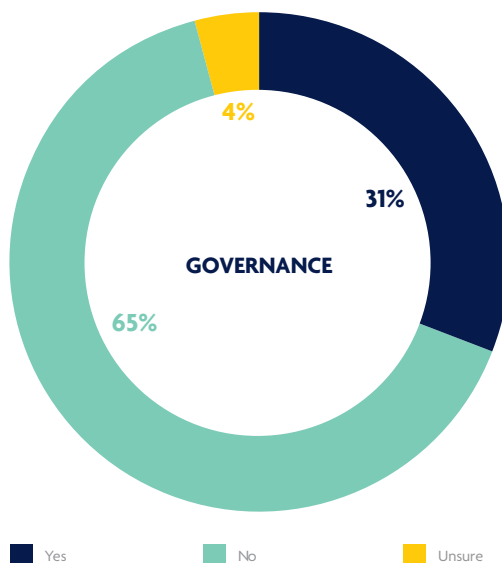


79 per cent of the respondents considered that those responsibilities were now clearer. However, a small but not insignificant minority of 21 per cent did not think matters had become clearer. Since this is one of the key drivers behind the SMCR, we expect that those promoting the new regime would be disappointed with the latter view.

MANAGEMENT CHANGES

One of the key concerns during the implementation of the regime was that it would require wholesale changes at executive or senior manager level in preparation for the introduction of the SMCR.

Governance: Did you make management changes (at executive and senior manager level) in preparation for the SMCR implementation?



31 per cent of respondents in governance functions indicated that their firm had made such changes whereas 65 per cent had not done so (the remainder were unsure). This included changes in membership of key governance committees, reporting line changes and clarification of the remit of responsibilities:

“Additional reporting lines [had been introduced] to ensure that all activity rolled up to a senior manager”.

Anecdotally, some firms reported a high turnover of staff following the introduction of the SMCR.

RECOMMENDATION

(see Recommendation 7)

Our report shows that there has been a meaningful and tangible change in culture, behaviour and attitudes towards risk within firms.

It is clear that the SMCR has focused senior managers' minds in terms of individual responsibility, but there is less evidence that others within firms have a similar focus.

However, we found others felt the new regime creates too much complexity and a focus on recording decisions.

Notwithstanding the latter concerns, the increased focus of senior managers upon their individual responsibilities and the measures taken to fulfil them is a clear positive feature.

Accordingly, we recommend that there should be further guidance on what reasonable steps in the context of the duty of responsibility should look like for senior managers and what types of reasonable steps frameworks should put in place. Although the FCA is apparently reluctant to provide any further detail or prescription itself, our recommendation is that this should be an industry-led publication to ensure high and consistent standards across banks and to allow firms and senior managers to share good practice and ideas.

If this recommendation is implemented, it should mean that senior managers will have even better tools to meet the requirements of the SMCR regime. This should in turn feed through more generally to the cultural tone of the organisation.

Processes around senior manager appointments, “business as usual” and senior manager departures

Undoubtedly, processes have changed to reflect and respond to the new SMCR requirements. For the most part, there appears to be consistency in implementation across the industry. Processes around the appointment of senior managers have clearly changed; senior managers are receiving specific training and independent legal advice in relation to their roles and requiring comfort around directors and officers insurance or indemnification arrangements, among other things. More focus is certainly being given to what a senior manager would do in the event of something going wrong for which he or she is responsible.

Employment terms have been changed and “business as usual” for senior managers has had to be adapted to meet their new obligations and responsibilities. The responsibilities and rights of senior managers following their departure from their respective firms has become a matter of focus for many (but by no means all) firms.

Our evidence indicates that senior managers carefully consider the potential impact of their conduct on future regulatory references that may be given. There is an apparent inconsistency in approach in the treatment of persons under investigation but who leave the firm prior to the investigation being completed. Some firms are choosing to note that the investigation had begun but was not concluded in any relevant regulatory reference. While others do not.

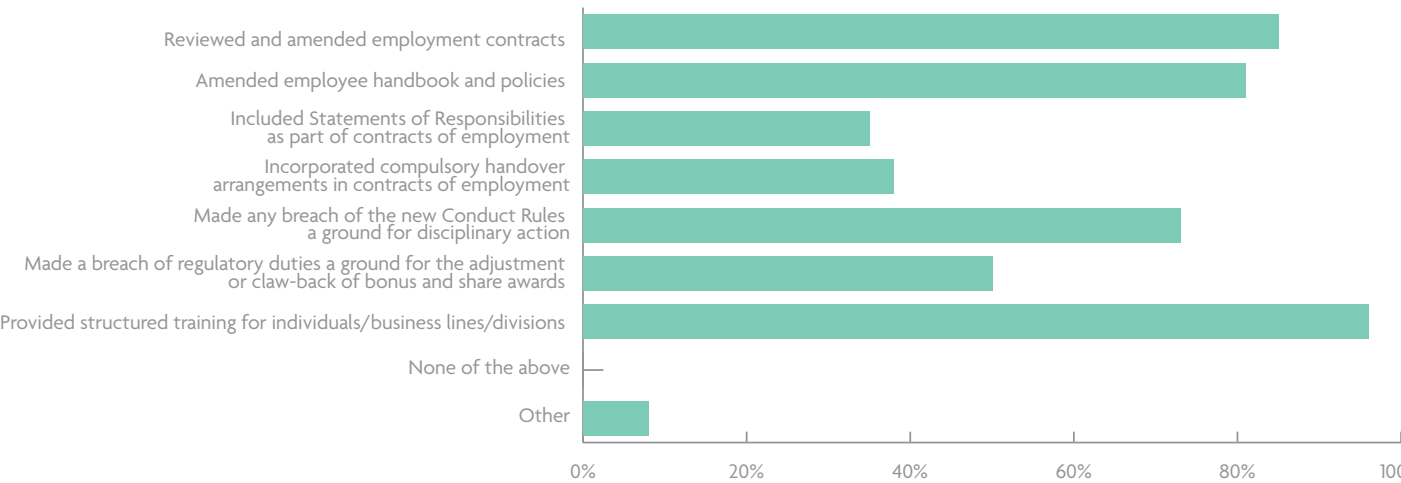
As anticipated, the results of the survey demonstrate that firms have adopted broadly similar approaches to the implementation and operation of the SMCR, particularly from an HR perspective. When drilling deeper, it becomes clear that there are subtle differences in approach, both at the implementation and operational stages (for example, we saw a spectrum of approaches taken by firms in amending the terms of employment of senior managers in the run-up to the SMCR implementation to accommodate the new regime, and differing approaches to certifying fitness and propriety in relation to firms’ senior managers and certified persons).

A pattern from the responses is that a number of different teams/departments within a firm are involved in the operation of the processes put in place to satisfy the SMCR’s requirements. This can be seen most notably in respect of assessments of fitness and propriety, the incidence of conduct rule breaches and in meeting regulatory reference requirements. The survey results demonstrate, therefore, that it is unlikely to be sufficient for firms to adopt a “silo” approach to SMCR compliance, with issues divided between and allocated to “HR” and “compliance” respectively. More extensive and effective collaboration within firms is necessary for the SMCR to operate consistently and effectively.

IMPLEMENTATION OF THE SMCR – SENIOR MANAGERS’ TERMS OF EMPLOYMENT

In many respects, teams tasked with implementing the SMCR appear to have adopted a relatively similar approach to amending terms of employment (contracts of employment and staff handbook documentation) to take into account the SMCR.

Governance: Which of the following did your firm do in preparation for the implementation of the SMCR?



By way of illustration:

- (a) 85 per cent of governance function respondents indicated there had been amendments made to the employment contracts of senior managers
- (b) 81 per cent of those respondents had amended employee handbooks and HR policies
- (c) 73 per cent of respondents had explicitly made a breach of a conduct rule grounds for disciplinary action
- (d) 50 per cent of the respondents had made breach of any regulatory duty a ground for adjustment or claw back of bonus/deferred compensation.

However, what cannot be fully ascertained through these responses are the variations within those approaches. For example:

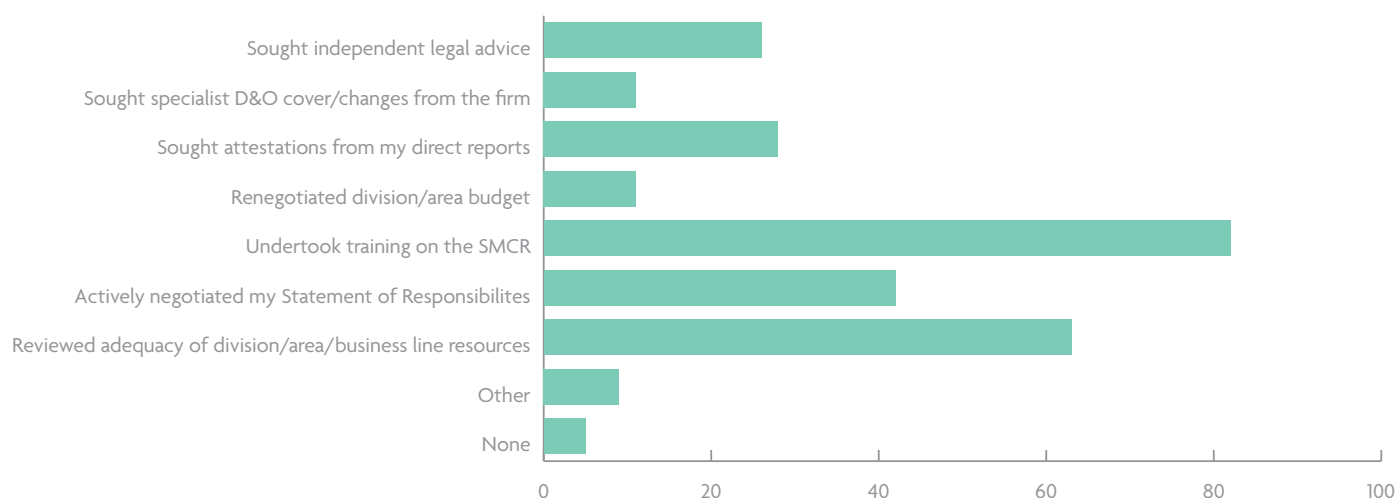
- (a) one governance function respondent indicated that their firm had only amended their employment contracts for new hires
- (b) only 38 per cent of governance respondents had expressly included handover requirements in the contract of employment of senior managers
- (c) only 35 per cent of respondents had embedded SoRs within the employment contracts of senior managers.

Therefore, while on the surface there would appear to be considerable consensus in the approach to SMCR implementation the underlying position is more nuanced, with subtle variations in the approaches being taken by firms.

APPOINTMENT OF SENIOR MANAGERS

We asked senior managers how the process of appointing senior managers had been adapted to meet the SMCR obligations.

Senior managers: Before becoming a senior manager, which of the following actions did you take?



Responses showed that training was by far the most important aspect for senior managers prior to their appointment. 82 per cent of senior managers undertook training on compliance with the SMCR regime prior to their appointment.

Additionally, one quarter of senior managers had sought their own independent legal advice in relation to the new regime's impact and its implications for them individually.

According to the controlled function respondents, almost three quarters (73 per cent) of firms offered senior managers their own independent legal advice in preparation for their appointment. Some boards had received their own independent legal advice. Other respondents indicated that senior managers had received advice as part of generic advice to the firm.

One controlled function respondent commented that the firm had offered senior managers their own legal advice “largely to help them better understand expectations relating to reasonable steps and confirmation regarding individual liability”. Another indicated that they retained external counsel for the firm and its management to provide generic training and guidance to the senior managers, while also providing all senior managers with an opportunity to discuss matters with a separate law firm individually. They also provided independent written legal advice by reference to the SoRs and other relevant documents.

Over a quarter (28 per cent) of the senior manager respondents said they had sought attestations from their direct reports at that stage.

42 per cent of the senior manager respondents stated that they had actively negotiated the terms of their SoR.

Only 11 per cent of senior managers had sought changes to their Directors & Officers insurance (“D&O”) coverage.

11 per cent of senior manager respondents indicated that they had sought to renegotiate business line or divisional resources, however, 63 per cent reported that they had reviewed the adequacy of their business line or division.

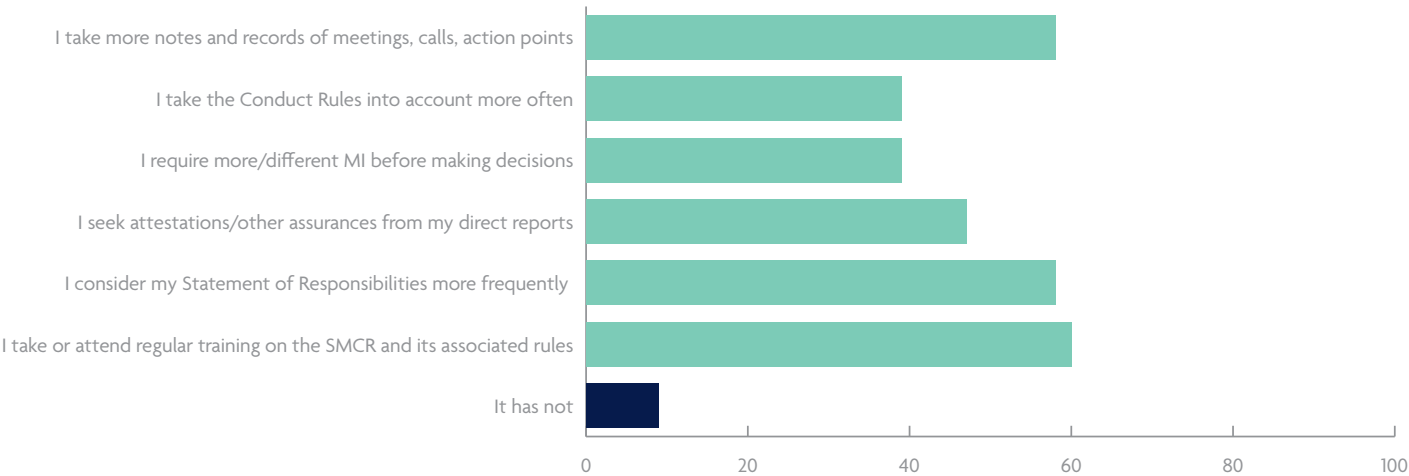
Only five per cent of the senior managers surveyed reported that they had not taken any of these steps.

We might expect that a due diligence exercise be undertaken by prospective senior managers in respect of the business and their role within it, to ensure that senior managers are comfortable with their responsibilities and have available resources to fulfil their role and to discharge their duties under the SMCR. This could include an appropriate retrospective review of conduct rule breach issues and red flags, and obtaining suitable assurance by means of attestations from relevant direct reports. The responses received should reflect an appropriate level of investigation and challenge prior to taking on the role.

BUSINESS AS USUAL FOR SENIOR MANAGERS

We asked senior managers whether and in what respects the implementation of the SMCR had changed their day to day working practices.

Senior managers: In what ways has the SMCR changed your day to day working practices?



Just nine per cent of senior managers reported that there had been no change to their working practices following implementation of the SMCR regime.

58 per cent of senior managers indicated that they now take more notes and make more records of meetings, calls and action points.

39 per cent indicated that they took the conduct rules into account more often.

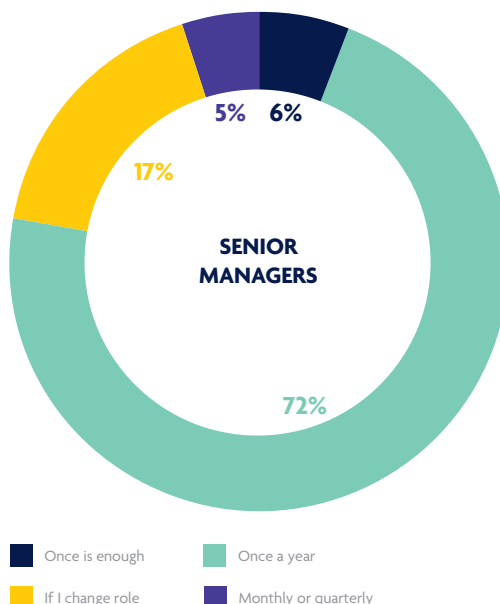
39 per cent indicated that they required either more or different management information since the SMCR had been implemented.

Around half (47 per cent) of senior manager respondents indicated that they now seek attestations or other assurances from their direct reports following the implementation of the SMCR. One respondent indicated that there was now a clearer distinction between when they were seeking the advice of a committee on a personally accountable decision as opposed to a decision delegated to a committee. This had accelerated some decision-making. Another observation in this regard was “I did the above previously - but I am more deliberate and explicit in my ability to evidence discharge of the SMR now”.

60 per cent of senior managers indicated that they attend regular training on the SMCR regime and associated rules.

We asked respondents how frequently training should be provided.

Senior managers: How often do you expect you will need to receive training on the Conduct Rules?



Most senior managers (81 per cent) expect that they will need training on the SMCR at least on an annual basis. A minority thought that once is (or was) enough or that further training would be required only when they change roles.

“As more information becomes available, interpretations change, training is necessary. I don’t think you can prescribe frequency. [Training should be provided at a] minimum of once a year.”

ARRANGEMENTS FOR SENIOR MANAGERS ON LEAVING THE FIRM

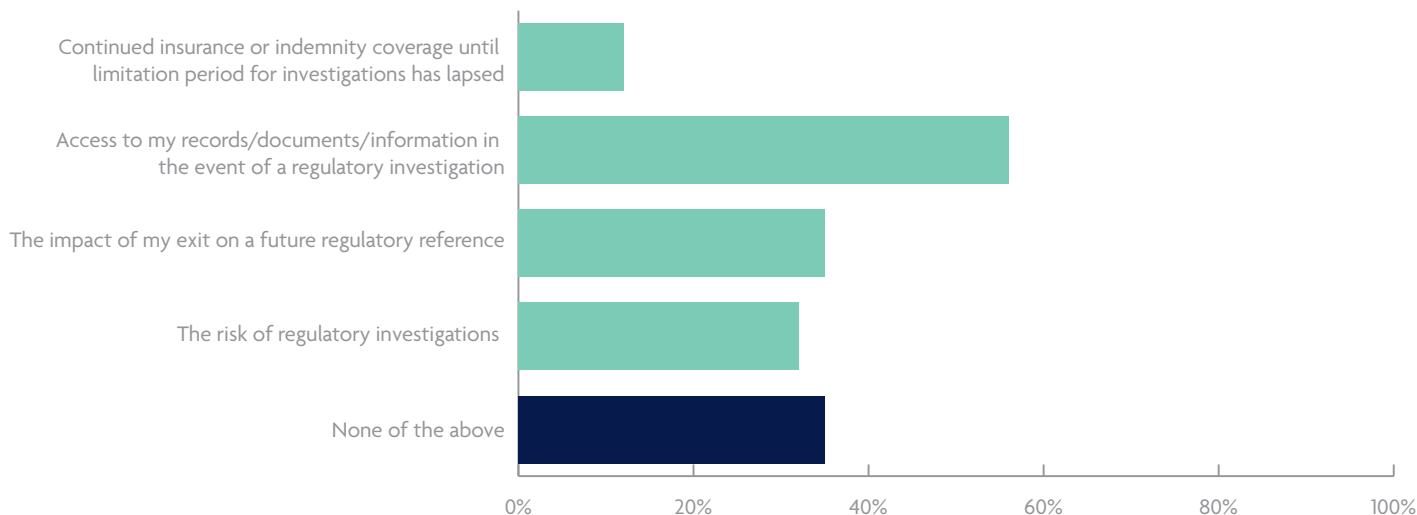
Senior managers were asked whether they had given consideration to or planned for the event of their leaving their firm.

In particular, they were asked whether they had considered:

- (a) whether insurance or indemnification would be available in the event of a regulatory investigation post-departure
- (b) whether they could gain access to their records, information and documents in such circumstances
- (c) whether they had given consideration to the impact and risk of such an investigation
- (d) whether they had considered the impact of his or her exit on future regulatory references.

The results suggest that there was limited consideration or planning for such outcomes by senior managers.

Senior managers: If you were to leave the firm tomorrow, which of the following have you already considered and/or planned for?



Only 12 per cent of senior managers reported that they had questioned whether they had continuing insurance or indemnity coverage in respect of a regulatory investigation commenced after their departure, but taking place during the relevant limitation period. In this regard, the limitation period for disciplinary action by the FCA/PRA is now six years.

Almost two thirds (65 per cent) of senior managers reported that they did not know how they would gain access to their records, information or documents after the end of their employment. It is likely that different firms will adopt different approaches to the degree of granularity of access by former employees to their records, perhaps reflecting different alignment of interests between the the firm and its former employee.

Surprisingly, only 32 per cent of senior manager respondents reported that they had considered or planned for the risk of regulatory investigations taking place after they had left their present firm. Considerations might include, for example, whether their former employer would provide support in terms of legal representation and cooperation more generally.

A slightly higher percentage of senior managers (35 per cent) reported that they had considered the impact of his or her exit on future regulatory references. In this regard, the SMCR introduced rigorous obligations on firms to seek, provide and update regulatory references in respect of senior managers and certification staff. Accordingly, on moving between SMCR firms the giving and taking of regulatory references now takes on even greater significance.

In contrast, around 35 per cent of the senior manager respondents indicated that they had not considered any of the issues described above in the context of departing from their current employer. The difficulty which this approach may present, however, is that it may well be impractical to raise these considerations after departure as the senior manager's leverage to seek comfort or concessions may well have been lost by then.

CASE STUDY 1

Firm X is a large UK headquartered bank. As all banks are required to do, it requests a regulatory reference from previous employers of a potential candidate from the past six years. Firm X's current policy is to reject any possible new hires who may have any adverse or negative disclosures on the candidate's regulatory reference. With a fairly large hiring pool (generally speaking), Firm X believes that there is a lower risk in rejecting what could be a potentially good candidate compared to putting in place enhanced measures to determine the fitness and propriety of such a candidate and/or systems to ensure that a person about whom there has already been a 'flag' is under enhanced supervision until the firm is comfortable that he or she is competent and understands what good conduct means at the firm. It is described as a zero tolerance for mistakes; the desire to provide an opportunity for rehabilitation is now gone.

RECOMMENDATION

(see Recommendations 3 and 5)

The new SMCR requirements have brought about changes in process which are broadly consistent across the industry. Our survey highlights that the process around the appointment of senior managers has clearly changed.

Likewise, employment terms have been changed and the rights of access of senior managers following their departure from their respective firms has become a matter of focus.

As a result of the surprising results that 65 per cent of senior managers do not know how they would access their records after they had left the firm if they were to be put under investigation, we are recommending that the FCA should implement a new rule that gives senior managers the right to access their records in the event of an investigation following their departure from the firm. This would give senior managers comfort that irrespective of the terms on which they leave, they will be able to access relevant records and files in the event of an investigation being launched.

Our evidence indicates that senior managers carefully consider the potential impact of their conduct on future regulatory references that may be given. In this context, we are also recommending changes to the regulatory reference requirements in relation to current FCA guidance on the treatment of persons under investigation but who leave the firm prior to the investigation being completed. The current FCA guidance on what firms should do in the event of a person leaving prior to an investigation being concluded is conflicting and unhelpful. It suggests that firms do not have to note that the investigation was taking place but may do so if they think it is relevant in relation to the new firm's decision. Some firms are choosing to note that the investigation began but was not concluded. This statement itself often leads the engaging firm to draw adverse inference against the person. Many respondents feel that better regulatory guidance on this issue and/or the removal of the question (g) on the regulatory reference form (which is another of our recommendations discussed below) would be beneficial.

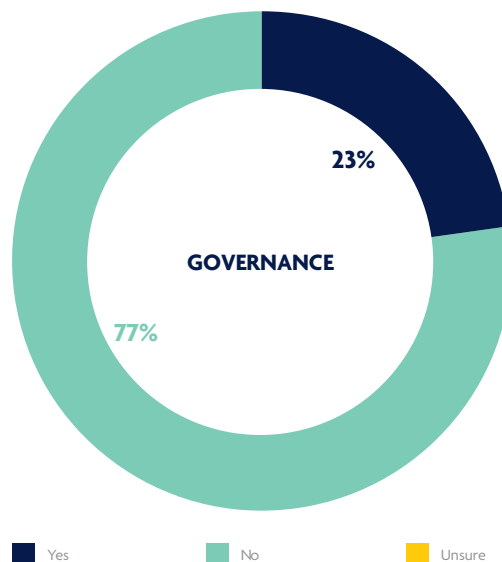
Taken together, both of these recommendations would give senior managers comfort in relation to the potential impact of certain actions going forward. These recommendations would also give firms and, in particular, human resources departments greater clarity over regulatory references.

Decision-making and the role of committees under the SMCR

There have been some significant changes in the approach taken to decision-making within most firms. The aims have been to better consider the relative risks, improve decision-making by more involvement of relevant control functions, and in part at least to avoid senior managers incurring any potential liability as decision maker. The role of some committees has also changed.

We were keen to examine the impact which the introduction of the SMCR has had on the quality and speed of decision-making within firms.

Governance: Do decisions now take longer and/or are support/control functions more heavily involved in decision-making since the SMCR was implemented?



A large majority of governance function respondents (77 per cent) did not believe that decision-making now takes longer than before the introduction of the SMCR. One respondent recorded:

“Business decisions do not take longer - however, it is probably fair to say that closer attention is paid to governance issues, where control functions may be more heavily involved.”

In contrast, 23 per cent believed that decision-making does now take longer.

One respondent indicated that on balance decision making did not take longer, but added:

“...there is a focus on getting the right people in the senior manager seats and the right senior manager model (if responsibility is being allocated to an existing senior manager), so in some cases this can take longer, but on the flip side there is improved clarity over who is responsible for the decision which can speed it up. Governance membership did not materially change with the introduction of the SMCR, as shared services were already actively engaged/represented”.

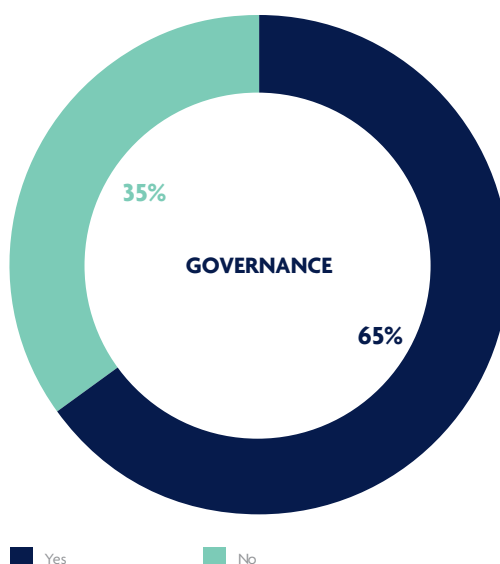
One respondent suggested that while decisions themselves do not necessarily take longer, the extent of documentation around decision-making has increased and in some respondents' views, those records had improved.

Another respondent commented:

“...decision-making processes are more integrated and in some cases more streamlined due to a better understanding of roles and responsibilities. However, additional personal responsibility can sometimes lead to more in-depth reviews and slower decision-making.”

The governance function respondents were also asked about whether there was greater involvement in decision-making on the part of those on compliance, legal or other risk management roles.

Governance: Is there now greater involvement of compliance/legal/risk with decision-making?



65 per cent responded that there is now greater involvement of compliance, legal and risk. One respondent commented:

“Decision-making is more holistic with the involvement of all relevant stakeholders.”

Another added that there is more involvement by risk and audit because of wider improvements to risk culture.

Although many respondents reported that there was increased involvement by control functions in decisions, this was not driven solely by the SMCR. One respondent commented that this “is more due to evolution in size and growth in business - not to do with the SMCR”.

Another observation was:

“[the] advisory role of second line functions and the legal team has developed since 2016”

The remaining 35 per cent did not consider there was any greater participation by those compliance, legal and risk functions. One respondent commented:

“Legal/Compliance/Risk were previously engaged in decision-making. That said, there is more careful consideration of Committee membership to ensure that they are included where appropriate.”

We asked senior managers in what ways the SMCR had changed their day to day working practices in respect of decision-making. 39 per cent indicated that they now took the conduct rules into account more often, while 39 per cent indicated that they now require either new or different management information for the purposes of decision-making. In addition, the responses of senior manager respondents around seeking attestations and other assurances from direct reports is also likely to be relevant in the context of senior managers’ decision-making.

Some senior managers reported that the SMCR had not caused changes to their day to day working practices in these respects because they already took account of the relevant rules, information and steps prior to the implementation of the implementation of the SMCR. A typical response was:

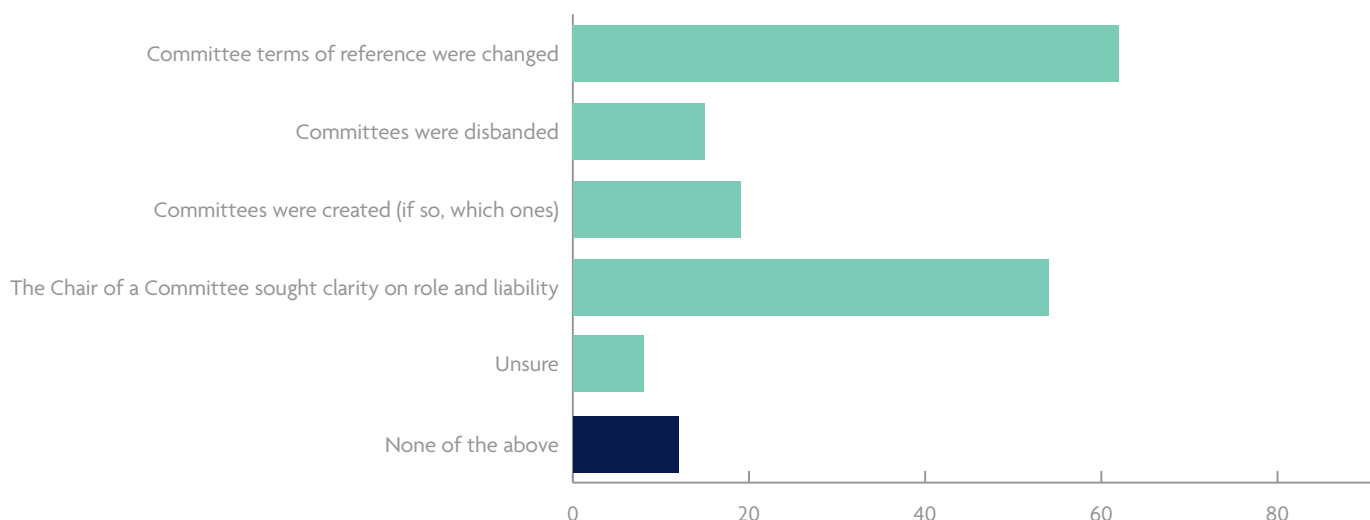
“I did the above previously - but am more deliberate and explicit in my ability to evidence discharge of the SMCR now.”

It is encouraging that the quality of decision-making generally was perceived to have improved in many cases, but without the existence of greater scrutiny or involvement of others slowing down the decision-making process itself.

COMMITTEES

We asked whether implementation of the SMCR had led to changes in committees operated by firms.

Governance: In preparation for the SMCR, did any of the following take place in relation to the use of executive committees?



In many respects, firms implementing the SMCR have had a real focus on the role and make-up of their committees. For example:

- (a) 62 per cent of governance function respondents reported that they had amended their committees' terms of reference
- (b) Over half (54 per cent) of those respondents had a chair of a committee who had sought clarity in respect of their role and liability
- (c) 19 per cent of those respondents reported that new committees were created in response to the implementation of the SMCR regime, while 15 per cent reported that existing committees were disbanded.

Reference was made to making changes to the membership of key governance committees. Some changes were made to directly support particular senior managers.

In the specific context of committee structures, respondents said:

- "In light of the SMCR and general good governance a full review was undertaken, which resulted in a change to the ToR, chair and membership for some board and executive committees"
- "A small number of UK-specific business management committees were introduced (where previously UK decisions were made in (global) functional committees). The board ToRs were updated."
- "In particular, consideration was given to 'member' vs 'attendee' status at certain committees. 'Member' implies decision making capacity and executive responsibility, whereas attendance does not."

As mentioned previously, one senior manager commented in this context that there was now a clearer distinction between when they were seeking the advice of a committee on a personally-accountable decision as opposed to a decision delegated to a committee.

Some respondents reported that many of the changes in committee structures were made to incorporate better practice or to ensure they were functioning appropriately, rather than being intended to meet a SMCR-specific requirement.

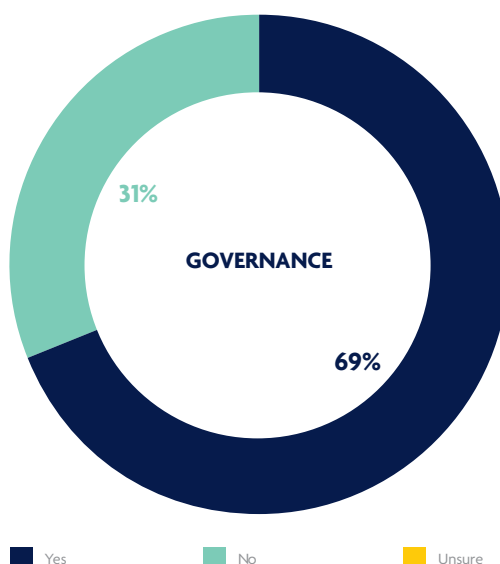
CASE STUDY 2

Firm Y wanted consistency, challenge and robustness of process in relation to conduct at the firm. So a committee was established to help the senior manager responsible for conduct rule breaches take certain decisions. One of the first issues for the committee was to establish its purpose: was it a committee that was used for the purpose of information gathering, where there is dispersed reporting and the senior manager could get updates from certain committee members; or was it a channel to be used to discharge the senior manager's responsibility with the committee acting in an advisory role with the senior manager taking the final decision? These questions were important in order to set the terms of the committee and how it would function. The use of a committee in this firm was seen as a way for the senior manager to discharge his or her responsibilities and part of the reasonable steps that he or she would be expected to take.

Appraisal process and fitness and propriety assessments

We asked whether firms' approaches to performance management such as the appraisal process and disciplinary actions changed in the light of the SMCR.

Governance: Has your approach to performance management such as your appraisal process and disciplinary actions, changed in light of the SMCR?



Over two-thirds of the governance function respondents (69 per cent) indicated that they have altered their approach to performance management, disciplinary and appraisal processes in light of the introduction of the SMCR regime.

One respondent mentioned that their performance-evaluation process had been enhanced and aligned with the requirement to make annual fitness and propriety certifications. Another mentioned that their approach to performance management had not changed but that managers were acutely aware of the need to complete thorough, robust, holistic reviews in relation to certified persons and senior managers. In this firm, they also now need to provide continuous feedback and not let performance issues linger; matters need to be dealt with promptly and robustly.

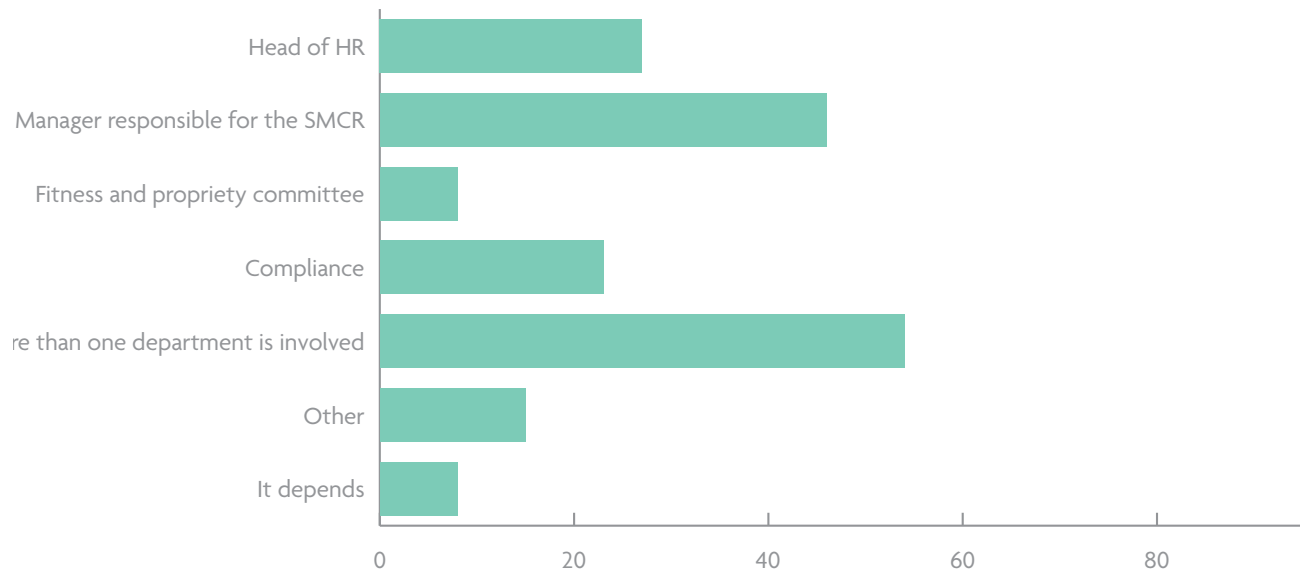
In relation to disciplinary action, respondents' comments were consistent:

- "In terms of disciplinary action we have increased focus on conduct risk but performance management is lacking"
- "disciplinary action is now considered through the lens of a possible conduct rule breach, rather than purely a breach of internal procedure for example"

- “the disciplinary framework was updated to include an HR review of potential conduct rule breaches, and reporting thereof”
- “a specific objective assessment of conduct rule breaches has been incorporated within the disciplinary process”
- “...disciplinary policy and processes were updated to incorporate an assessment of whether or not a breach of the conduct rules had occurred.”

We asked how firms assessed fitness and propriety, and in particular, who was responsible for such assessments.

Governance: Who is responsible for the assessment of fitness and propriety at your firm?



Interestingly, it appears there is no uniform approach or consensus regarding who is responsible for making assessments of fitness and propriety. The most common response was that more than one function was involved in the determination, although a number of the respondents highlighted that line managers often take considerable responsibility for making the “first-line” assessment, with support from HR, compliance and senior managers as required. Governance function respondents commented that:

- (a) “the assessment of fitness and propriety is ultimately a decision for the part of the business employing the individual, but the decision was guided by advice sought from relevant subject matter experts within regulatory affairs, legal and HR, as required.”
- (b) “each individual is assigned a fitness and propriety manager responsible for undertaking the assessment, but HR manages the overall process with input and guidance from legal, compliance and other relevant stakeholders. Ultimately, the CEO has responsibility for ensuring compliance with obligations under the SMCR regime.”
- (c) “the chief compliance officer has the ultimate say but, depending on the scenario, input will be sought from HR, compliance, employment legal, the General Counsel and others.”

- (d) “compliance provides the policy standards and, together with HR, provides the key procedures for the various elements of the process. The decisions themselves sit with the compliance line management and relevant senior manager.”
- (e) “the framework is owned centrally, but each individual manager of certified staff is responsible for assessing the fitness and propriety of their staff.”

The key themes which can be drawn from this are:

- (a) where decisions are being taken at line management level, it is essential that those making the decisions fully understand what the SMCR requires, the contents of the fit and proper test, and the need to escalate issues appropriately (ultimately, any failings in this regard will reflect on the senior manager with responsibility for ensuring compliance with the certification regime).
- (b) firms cannot take a “silo” approach to SMCR compliance. Assessing fitness and propriety is likely to be multi-faceted and to require, at a minimum, extensive cooperation between the HR and compliance teams.

One unanswered question is the extent to which firms are applying standards consistently when undertaking assessments, and the extent to which the focus of these assessments is (or is not) influenced by the identity of the person or department tasked with leading the assessment.

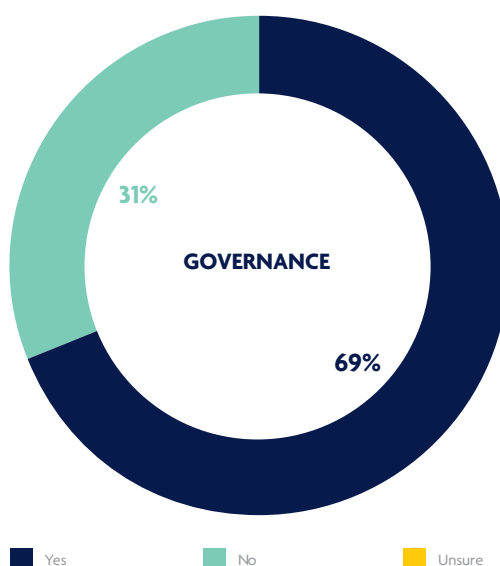
BREACHES OF CONDUCT RULES

We asked whether firms had yet identified breaches of the conduct rules.

Governance: Have you found anyone to have breached the new conduct rules?

69 per cent of the governance function respondents reported that they had identified conduct rule breaches by employees since the SMCR was introduced. Unsurprisingly, smaller firms tended to be less likely to have found any breaches (in all probability due to the relative size of their employee population).

We asked about the process for identifying conduct rule breaches and who



ultimately makes this determination. As can be seen, conduct rule breaches are detected from and determined by a number of different sources (line management, HR, compliance or a combination of all of these). Other functions that may do so include control type functions such as risk, legal, front office controls and surveillance and IT security. The governance function respondents made clear that firms have a variety of different approaches to this process, with some incorporating the conduct rules analysis into any HR disciplinary, clawback and variable compensation processes and adding it as a second stage after any HR disciplinary process.

The majority of the responses further reinforce the fact that a “silo” approach is not appropriate when operating the SMCR and that it is important for the different functions to liaise and cooperate effectively to ensure that actual and potential conduct rule breaches are detected and handled appropriately and consistently.

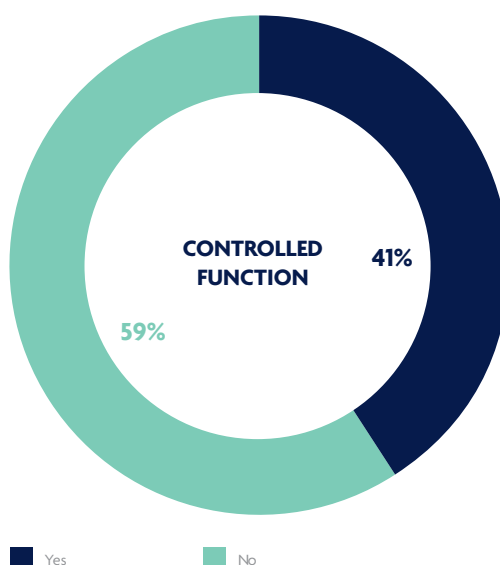
CASE STUDY 3

Firm Z had been conscientiously following regulatory guidance on the classification and reporting of conduct rules. Its policy was very clear and reflected the PRA and FCA Handbook rules on determining what amounts to a conduct rule breach. Following its most recent submission of its annual notification of conduct rule breach, the FCA called to query why some of the conduct rule breaches which had been set out in the annual notification had not been notified at the time they occurred. In essence the suggestion is that the Principle 11 notification threshold is now lower than the annual notification of conduct rule breaches. Furthermore, it is generally expected that if something is notified to the PRA it should be notified to both regulators. And the high turnover of staff at both organisations means that it can be quite cumbersome for firms to set out the necessary background, particularly in this case where Firm Z's contact at the FCA was in the call centre, rather than being a directly named supervisor. Firm Z finds this administratively burdensome as well as overly conservative in terms of what it has to notify to the FCA and PRA.

CERTIFIED STAFF

We asked whether firms had found it difficult to identify those individuals who fell within the certified person regime.

Controlled Function: Have you found it difficult to identify persons required to be certified under the SMCR?



59 per cent of the respondents indicated this had not proven difficult but a significant number (41 per cent) did not agree that it had been straightforward.

It was felt by a number of controlled function respondents that the criteria used to define the population of certified staff meant that it captured more junior staff within organisations, whose role does not justify such enhanced supervision.

Respondents commented:

- “the definitions in the MRT EU Directive are very wide and can encompass some staff whose risk profile is very low”
- “we have faced challenges particularly with material risk takers under Article 3. This ends up catching too [many] staff in a small bank”
- “Whilst the key roles are obvious and the [senior manager functions] are relatively straightforward, there are on occasions debates about how far the certified functions should extend”.

Often, the difficulty lies where there are overseas individuals who may come to the UK, perform activities on behalf of the UK or deal with UK customers. Respondents commented:

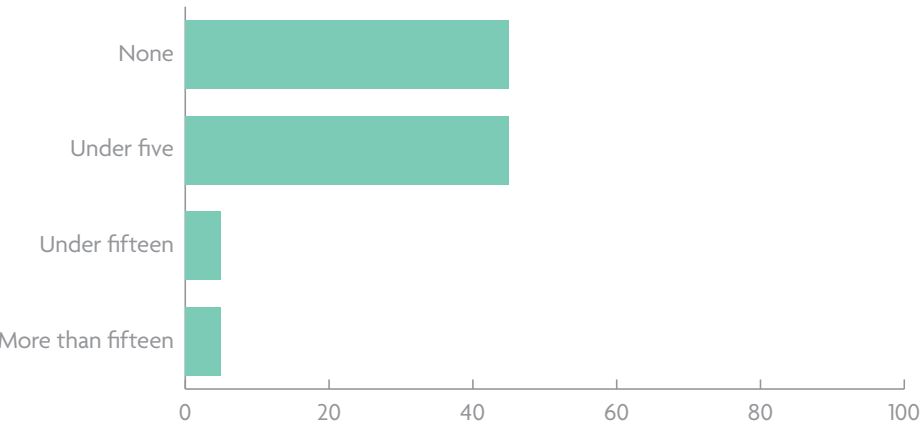
- “In general the process of identifying the bulk of the certified population is relatively straightforward. However, there are some challenges in deciding whether certain roles at the margin should be included – e.g. individuals overseas who may occasionally deal with UK customers...”

- “The only challenge we had was in relation to teams of people work[ing] offshore that may come to the UK or perform relevant activities on behalf of the UK...”
- “Individual[s] dealing with clients is challenging, due to the 30-day threshold and multiple countries.”

We would observe that there is an ongoing administrative burden to ensure that organisational changes are reflected in the certification population. For example, where someone picks up new direct reports who are a certified person, then the manager will become a certified person themselves (if they are not already).

Another issue we wanted to explore was the extent to which firms had been unable to grant a certificate of fitness and propriety to employees since the SMCR regime was implemented.

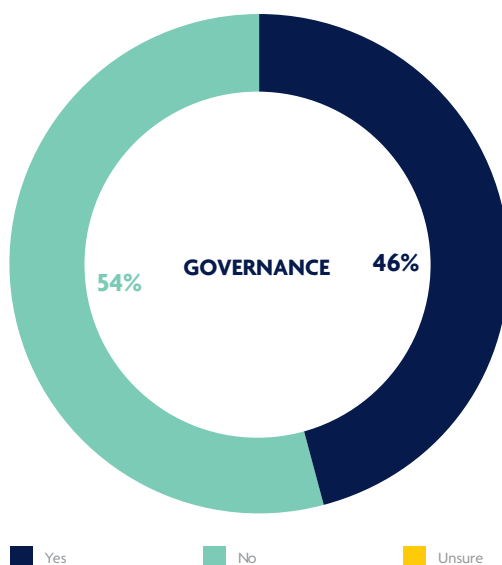
Governance: How many employees have you been unable to grant a certificate of fitness and propriety for since the SMCR began?



We found the extent to which firms professed to having been unable to do so surprising. The results from controlled function individuals showed that the majority had been unable to certify at least one employee, while five per cent had found themselves unable to certify in respect of 15 or more individuals. Another five per cent of the respondents had been unable to certify between 6-15 employees. 45 per cent of the respondents indicated they had been unable to certify between one and five persons and 45 per cent had been able to certify in all cases. This would suggest that the aim of removing rolling bad apples from the industry is actually working.

We asked those performing governance functions whether they had terminated any individual’s employment as a result of a failure to pass certification (either at initial assessment or after ongoing renewal).

Governance: Have you terminated any individual's employment as a result of a failure to pass certification (either at initial assessment or after ongoing renewal)?



46 per cent indicated that they had done so. Respondents commented that:

- “In very rare cases, graduate new joiners to the firm have been unable to pass the requisite exams and as such have not met the criteria for being fit and proper to be certified”
- “We have had instances where an individual employment offer for a role was not progressed due to information reviewed as part of the fitness and propriety assessment at the hiring stage”
- “Though no individuals have been dismissed as a direct result of failing to pass certification, some employees’ contracts of employment have been terminated as a result of their failure to secure a role through redeployment, if for example they have failed to obtain a regulatory qualification and subsequently cannot perform a certified role. Such individuals would most likely have had their employment terminated even in the absence of the certification regime, as they were unable to meet [the FCA’s Training and Competence] requirements.”

RECOMMENDATION

(See Recommendations 1, 4 and 6)

Firms must now make careful assessments of their senior managers and certified persons' fitness and propriety and are adopting different approaches, including between the larger and smaller banks.

Disciplinary processes have also changed, with many respondents indicating they had already made decisions around conduct rule breaches. In relation to the certification regime, some felt those in scope included a number who are too junior, and had concerns about whether overseas-based "fly-in" staff are or are not impacted. Most respondents had found it easy to certify staff, save those who failed to secure the necessary qualifications.

Accordingly, while the overall picture in this context may be positive, we consider that there are a number of steps that should be taken with a view to improving the overall process and lessening any inappropriate impact on the organisation. In this regard, we therefore recommend that:

- (a) the criteria for certified staff is narrowed to reduce the population of those who are caught. The FCA has taken some steps towards this by limiting the client dealing certification function to those who exercise judgment or discretion. However, further steps should be taken so that staff are not caught unnecessarily, for example, as a result of the definition of material risk taker and in particular how that would apply to smaller institutions.
- (b) in response to the reports around divergence of approach to conduct rule breach reporting, guidance should be produced to provide a level of consistency on what firms consider to be conduct rule breaches, the interaction with disciplinary processes and the impact on disclosures made in regulatory references. We are recommending that this guidance be produced by industry for industry, rather than the regulator.
- (c) question (g) on the regulatory reference template form should be removed. Our recommendation in relation to the regulatory reference form is led by the concern in the industry that as firms' risk tolerance of engaging candidates with 'qualified' references reduces, candidates will be excluded from the hiring process who are otherwise fit and proper or who could bring a different level of experience from overcoming a previous event if firms' tolerance was higher.

(d) the “one size fits all” approach to the SMCR for banks should be replaced with a level of proportionality that would allow certain smaller firms to be treated more like a ‘core’ firm under the extended rules for solo-regulated firms. This would mean that such firms would not need to complete and maintain MRMs or handover processes. We can see from the responses below and our review of the data that the burden of some of these requirements affects different types of firms disproportionately. We are not suggesting that flexibility should be taken away from firms, but smaller firms should be given the option to be treated like their peers in the non-bank finance industry.

We consider that the implementation of these recommendations will have significant advantages while at the same time having little or no negative impact upon the effectiveness of the SMCR regime.

Time to review

There have been some unintended consequences for the financial services industry as a result of the SMCR rules. Here we set out some of the impacts that firms have reported as a result of the rules.

RECRUITMENT

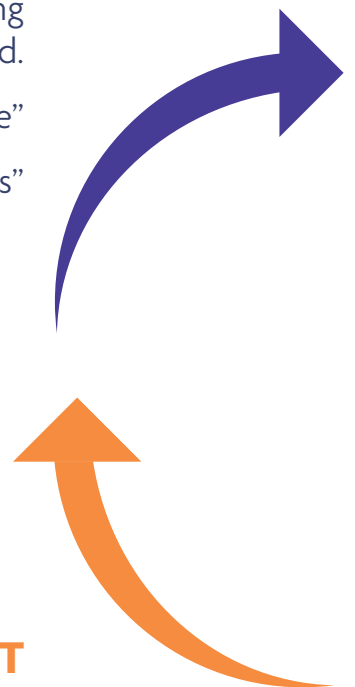
Firms are taking a more risk adverse approach to the recruitment of individuals. Candidates who have anything other than a clean regulatory reference are not being engaged.

“There is no appetite to giving people a second chance”

“There is a zero tolerance towards making mistakes”

CONDUCT

The FCA’s rhetoric about non-financial misconduct has had an impact on how firms view the conduct rules. Generally the zero tolerance approach to misconduct has improved culture in firms.



NOTIFICATION

But there is some divergence over the level at which breaches of conduct rules should be notified to the regulator. Following the regulatory rules (particularly on annual notifications) has often led firms to receive questions from the regulator over why something has not been reported sooner or at the time it occurred. Anecdotally, this has often led firms to submit Principle 11 notifications where a conduct rule breach would otherwise be submitted annually or even not at all.

REFERENCES

All of this culminates in firms providing regulatory references which “disclose” actions or issues which otherwise would not be provided in a simple reference. Despite individuals being competent, facts may be disclosed against an individual on a regulatory reference particularly because of the catch all question set out in the regulatory reference template. This leads on to what a hiring firm might do on receiving it.

SMCR-related key documents

Recording and mapping responsibilities under the SMCR is of paramount importance. Under the SMCR, firms must comply with extensive requirements around preparing and maintaining certain key documents such as SoRs, MRMs and senior manager handover documentation.

We were keen to understand how firms went about the task of ensuring the relevant requirements and related regulators' expectations were met. The results show that firms have taken these requirements seriously and implemented processes which support regulatory compliance with those obligations.

In addition, we identified that there was a clear focus on note-taking by senior managers as evidence of how they would discharge their duty of responsibility.

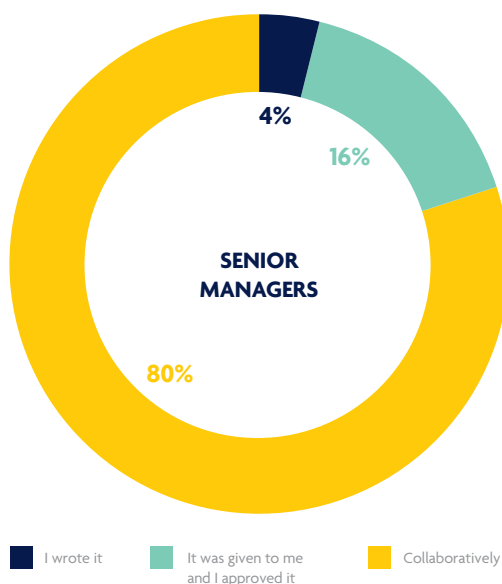
One of the most surprising outcomes of our report is the focus that firms are giving to regulatory references. Firms have implemented changes to their procedures to ensure that they can comply with regulatory reference requirements (including the obligation to update a reference given). More significantly, we noted a change in risk appetite in respect of recruiting candidates who have any form of 'qualified' regulatory reference (e.g. where something negative is disclosed on a reference received). Many firms are reporting that they will reject a candidate on the basis of any negative indication. Our graphic on the previous page shows the circuitous impact of this on the industry. There is therefore a reduction in the appetite for forgiveness, which some firms who value people's diverse experience and backgrounds question.

STATEMENTS OF RESPONSIBILITIES

A key cornerstone of the SMCR is the requirement that senior managers must have and maintain up to date SoRs. These are required to provide a concise account by the senior manager setting out what he or she is responsible for within the firm. For banks, these documents are submitted to the relevant regulators. They will also no doubt be relied upon by the relevant regulator as the key to imposing individual liability on senior managers in the event of firm misconduct, including use in the course of any related investigation. They will become a core supervision and enforcement tool.

We asked how and by whom SoRs had been prepared.

Senior managers: How was your Statement of Responsibilities written?



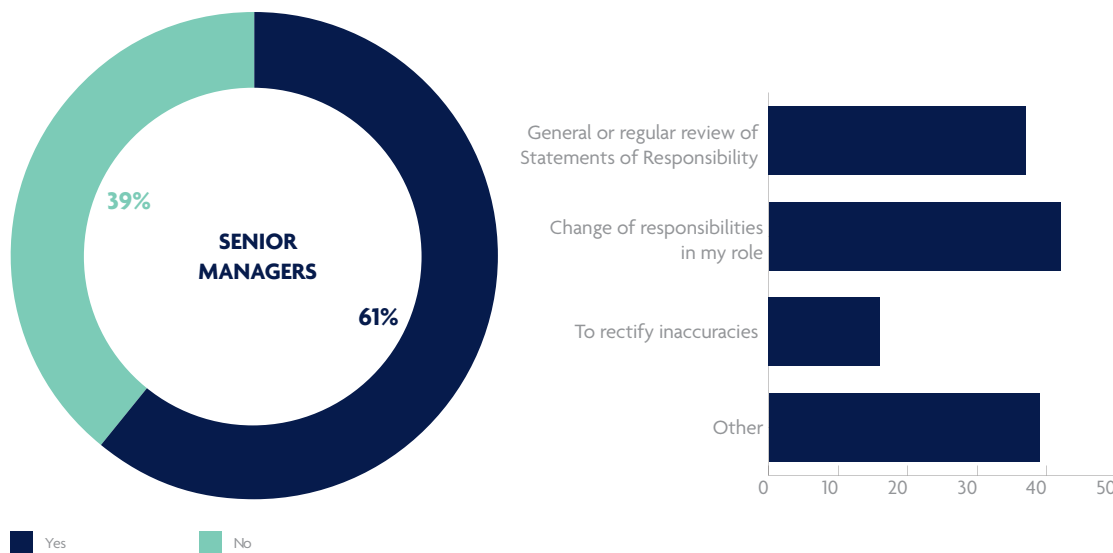
Only four per cent of senior managers reported that they had written their SoRs themselves. In contrast, 81 per cent of senior managers who responded reported that their SoRs were written in collaboration with others, in some cases both internally and externally. One senior manager added that their SoR was developed in conjunction with the other key executives as a collective leadership group, in conjunction with the collective development of the firm's MRM.

The remaining 16 per cent of senior manager respondents indicated that their SoRs were provided to them by others and they approved it.

Separately, we asked whether senior managers revisited their SoRs frequently. 58 per cent of the senior manager respondents reported that they do consider their SoRs frequently.

There is also clear evidence to suggest that the SoRs are “living” documents. The purpose of a SoR is to show an accurate reflection of a senior manager’s responsibilities at any point in time.

Senior managers: Since becoming a senior manager under the SMCR, has your Statement of Responsibilities changed?
If yes, was the change because of any of the following?



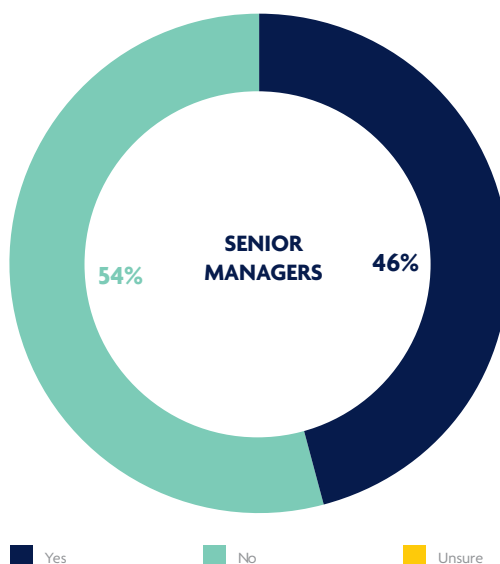
61 per cent of senior manager respondents said that their SoR had changed since they had become a senior manager. 60 per cent of those who said their SoR had changed indicated that the changes were as a result of general or regular reviews, whereas others reported the changes were made by reason of a change of responsibilities in respect of their role or because of organisational restructuring. Some noted that such changes may not be major but were more minor adjustments or rectifying inaccuracies. A number of respondents said their SoR had changed due to two or all three of the above reasons, indicating that the same SoR had been amended on multiple occasions for different reasons.

The responses demonstrate that a diligent approach is being taken to keeping the SoRs accurate and to reflect good practice in light of the relevant SUP requirement to ensure the documents are kept up to date.

We asked governance function respondents whether the creation of SoRs had had a knock-on effect in relation to senior managers' job descriptions. 77 per cent of the respondents indicated that they had. This is perhaps a surprisingly high number but may demonstrate that job descriptions previously tended to remain more static. Respondents confirmed that job descriptions had been realigned to match the SoRs. One respondent indicated that only limited changes were made to reflect governance and committee roles and delegation on responsibilities. Another commented that job descriptions were reviewed and updated annually, but where a change in allocation of responsibilities had been required the job description was updated to reflect this immediately. Another said that refinements were made in job descriptions to better reflect prescribed and other responsibilities. One respondent referred to the cross-referencing of SoRs in the job descriptions and another referred to SoRs and job descriptions being created alongside one another.

We also asked whether there had been any reduction in the sharing of responsibilities between senior managers since the SMCR was implemented. In this regard, it might be said that the SMCR implicitly discourages the sharing of responsibilities.

Governance: Has there been a reduction in shared/joint responsibilities between senior managers since the SMCR was implemented?



Governance function respondents were divided more or less equally in their response on this issue. One observation made in this regard was that the SMCR had secured the removal of ambiguities and had helped to clarify roles. Another respondent also referred to the increased clarity regarding ownership of responsibilities between the first and second lines of defence.

Other comments included:

- “I would not say there has been a reduction in shared responsibilities, but there has been a focus on clarifying where one SMF’s responsibility starts and another’s ends.”
- “We have reduced the number of co-heads in the front office.”

MANAGEMENT RESPONSIBILITIES MAP

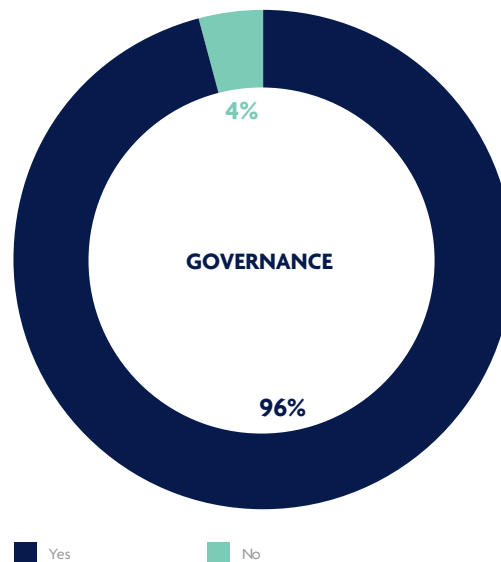
Almost half (42 per cent) of governance function respondents reported that the responsibility for maintaining/updating the firm’s MRM fell to the compliance function. Of the remainder, over a quarter (27 per cent) indicated that it was the task of a specific team employed for this purpose and 19 per cent said that a specific person was employed for this purpose. In addition to compliance, it may sit with the COO’s office or within the governance or legal function. Only one respondent indicated that a specific senior manager was responsible for the MRM.

Accordingly, there was a divergence in approach between firms in how the respective firms’ MRMs were maintained. Some respondents emphasised that individual senior managers are aware of the need to inform compliance when there had been changes that impact the MRM and senior managers are expected to be involved in the updating process.

HANDOVER

We asked about arrangements made to manage handovers between outgoing and incoming senior managers.

Governance: Does your firm have a detailed senior manager handover procedure?



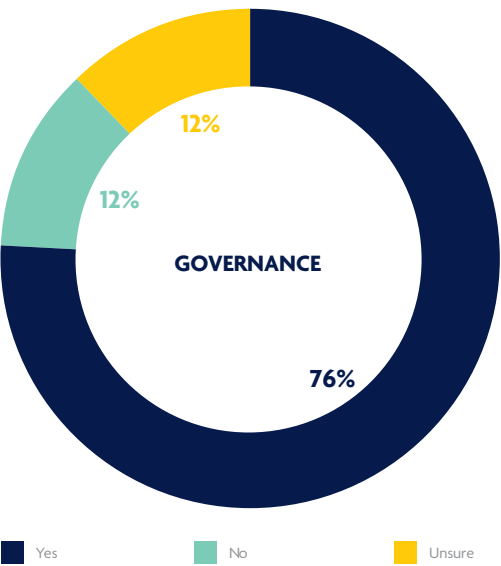
All but one of the governance function respondents reported that they had a detailed senior manager handover procedure. At the same time, only 65 per cent of the respondents had a procedure that made provision for situations involving “bad leavers”. Some respondents noted that their procedure was more ad-hoc than formalised. Handover materials are generally provided to a new senior manager on day one (62 per cent) with only 15 per cent of respondents indicating that such material would be provided pre-contract. One respondent added that the provision of handover material may be dependent on regulatory approval being received. This means that some senior managers may not receive handover materials until after they have started, if their regulatory approval has not yet been received.

One method referred to in the responses for ensuring an incoming senior manager is provided with sufficient information is for the necessary material to be gathered from direct reports of the outgoing senior manager, to supplement any incomplete handover.

REGULATORY REFERENCES

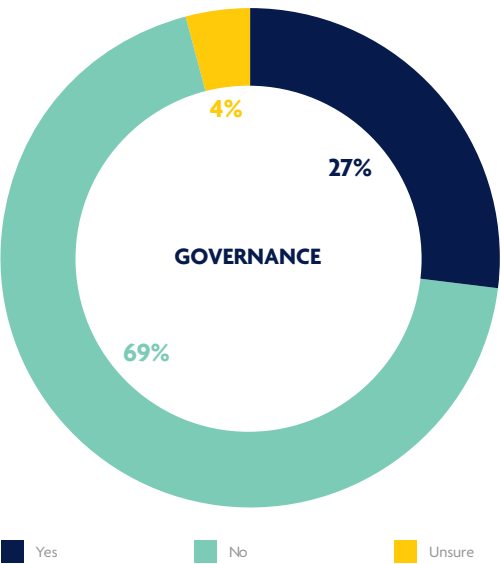
We wanted to know whether firms had been obliged to change their record-keeping procedures in light of the enhanced requirements around regulatory references. We also asked if they had been obliged to update any references previously provided.

Governance: Has your firm changed its record-keeping procedures in light of the requirement to give regulatory references?



Over three quarters (77 per cent) of governance function respondents indicated that their firms have changed their record-keeping procedures in light of the requirement to give regulatory references. For some this has meant extending timescales on record retention (for example to align with the requirement to disclose serious misconduct beyond six years). One respondent also said that the “tagging of Certificated Persons in the HR system has improved accuracy of data”.

Governance: Have you ever updated a regulatory reference previously given?



Some 27 per cent of governance function respondents indicated that they have had to update regulatory references they had previously given (and one respondent noted that they had received a reference which later required updating). We consider that this is a higher number than we might otherwise have expected, but it serves to demonstrate that this is an area on which firms are focusing, and that providing updates will become a relatively frequent occurrence. We suspect that that the resources needed to meet these obligations are likely to be significant.

Of potentially greater significance is the anecdotal evidence to suggest that firms are very cautious about hiring anyone with a “qualified” regulatory reference.

“Hiring decisions may be more conservative. If anything [is] noted on [a] reference, [we are] unlikely to hire.”

Although anecdotal, this comment does suggest that firms are taking the contents of the references they receive seriously, and that firms are actively engaging with the reference updating process. However, there is a risk that an approach of not hiring anyone with a qualified reference, if it were to become widespread, may have a chilling effect on what is included in references. It could result in market practice which is not necessarily aligned with the requirement to disclose any information which the referee “reasonably consider[s] to be relevant to [the hiring firm’s] assessment of fitness and propriety” (question G on the regulatory references form).

Moreover, the change in risk appetite in respect of recruiting candidates who have any form of ‘qualified’ regulatory reference (e.g. where something negative is disclosed on a reference received) is potentially concerning. Many firms reported that they will reject a candidate on the basis of any negative indication. This apparent reduction in the appetite for forgiveness can have potentially unfair and disproportionate career ending consequences.

Yet again, the area of preparing and, if necessary, updating regulatory references requires extensive cooperation between HR and compliance teams in order for the SMCR to operate effectively.

CASE STUDY 4

Firm A had recently investigated a senior manager as a result of certain allegations that they had made some comments to a colleague, albeit comments were inappropriate, rather than discriminatory, bullying or harassment. An internal investigation was launched into the conduct of the senior manager. Part way through the investigation the senior manager resigned (which was accepted). A few months later a regulatory reference request was received by Firm A in relation to the previous senior manager. The question for Firm A was what to put in question G of the regulatory reference template form which asked for any other relevant information. The fact of the formal investigation was potentially relevant to a new employer, but it was unverified as a result of the resignation. Alternatively, firm A could leave it blank. Firm A considered the fairness to the previous employee, future employer and industry as a whole. Firm A decided to include a reference to the investigation of the previous employee on the form, which led to the employee's offer being withdrawn.

D&O INSURANCE/INDEMNIFICATION

Almost three quarters (73 per cent) of governance function respondents indicated that their firms reviewed their D&O insurance or indemnification arrangements prior to the implementation of the regime. Respondents were split on the effect of their review: some reported considerable negotiation and increase in cost; others reported no material changes. One governance function respondent commented:

“policy text updated. Changes aligned to existing group position on cover for staff.”

However, another stated:

“D&O cover was assessed as part of the SMCR implementation, but the SMCR did not lead to material changes.”

“A review was undertaken, but there was no change in the firm's position.”

We have previously mentioned that few senior managers questioned the scope of their D&O cover when appointed as such under the SMCR.

RECOMMENDATIONS

(Recommendations 1, 2 and 4)

Recording and mapping responsibilities under the SMCR involves extensive requirements around preparing and maintaining key documents such as SoRs, MRMs and handover documentation.

Our findings indicate that firms have taken these requirements seriously and implemented processes which support compliance with those obligations. There was also a clear focus on note-taking/other record keeping by senior managers to evidence their discharging the duty of responsibility.

A surprising finding was the focus given regulatory references. Firms have made changes to ensure that they can comply with regulatory reference requirements (including the obligation to update a reference given). More significantly, we noted a change in risk appetite in respect of recruiting candidates who have any form of 'qualified' regulatory reference (e.g. where something negative is disclosed on a reference received). Many firms reported that they will reject a candidate on the basis of any negative indication. This apparent reduction in the appetite for forgiveness, having potentially unfair and disproportionate career ending consequences, is a concern.

In the light of the points, we recommend that:

- (a) reflecting on the administrative burden on firms which respondents described, some of the requirements should be removed or alleviated. For example, the requirement for firms at all times to have a comprehensive and up to date MRM could be reduced so that there is a yearly or bi-annual update to this document.
- (b) as mentioned above, there should be industry guidance produced on what reasonable steps should look like for senior managers and what types of reasonable steps frameworks firms should put in place.
- (c) as a result of the evidence suggesting that firms are adopting an ultra-cautious or zero tolerance approach to any candidates whose reference is 'qualified', question (g) on the regulatory reference form should be removed. This 'catch all' question often leads firms to disclose matters which will affect the decision of the hiring firm. Our recommendation is based on the fact that there is sufficient specific information requested by the form without the need for a catch all question.
- (d) the "one size fits all" approach to the SMCR for banks should be tempered with a level of proportionality for smaller firms.

Once again, we anticipate these changes will have a positive impact while not detracting from the effectiveness of the SMCR regime. We are concerned that the zero tolerance approach identified is introducing potential unfairness with unjustified and disproportionate, career ending results.

RESOURCES

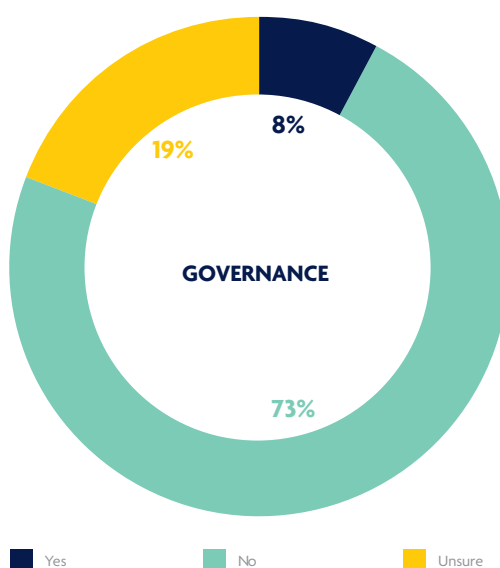
The SMCR has not led to an exodus of people from the industry. There is little evidence to suggest that people have left or relocated so as to avoid the impact of the SMCR. Indeed, some firms have bulked up on resources to support SMCR compliance.

Notwithstanding the comments we set out above concerning the impact of disclosures made on regulatory references, there is otherwise little evidence that the recruitment of senior managers is any more difficult or costly since the SMCR was implemented. However, firms do consider the burden of complying with the SMCR is significant in terms of resources.

RECRUITMENT AND REMUNERATION

We asked respondents whether the implementation of the SMCR had led to difficulties in recruiting or retaining senior managers.

Governance: Has implementation of the SMCR led to difficulties recruiting or retaining senior managers?

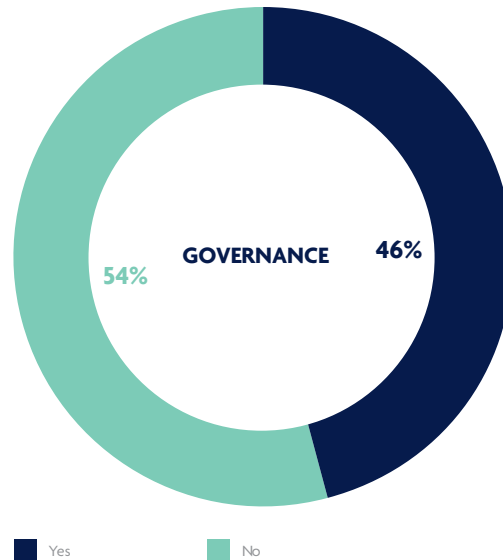


73 per cent of governance function respondents said that implementation of the SMCR had not led to any additional difficulties in recruiting/retaining senior managers. Eight per cent were of the opposite view, indicating that it had made recruitment more difficult, with the remainder being unsure.

One respondent suggested that the SMCR has made it more expensive to recruit senior managers, with individuals requesting additional remuneration in exchange for taking on the risk of being a senior manager - "individuals expect to be paid more for taking on a SMCR role".

We separately asked whether there was any perception that the implementation of the SMCR had an impact on remuneration paid by firms.

Governance: Do you perceive that the implementation of the SMCR had an impact on remuneration paid by the firm?

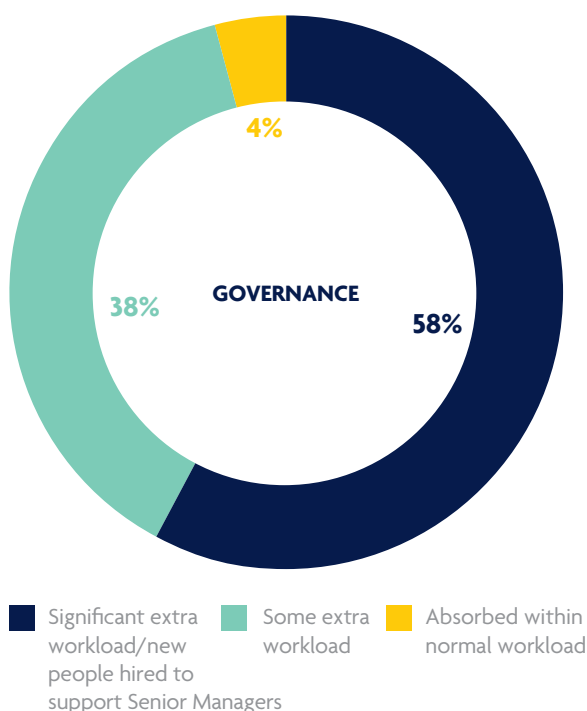


Interestingly, responses to the question regarding whether the SMCR has had any impact on remuneration were much more evenly split, with 46 per cent of governance function respondents acknowledging that that the introduction of the SMCR has had an impact on remuneration. However, some of the comments made suggest that the impact may relate more to remuneration processes (including deferrals and malus/clawback provisions) rather than to absolute levels of remuneration. A possible alternative conclusion is that at least some firms have found that recruiting has become more costly as a result of implementation of the SMCR, potentially reflecting a “premium” for the additional personal exposure it carries with it.

WORKLOAD AND HUMAN RESOURCE

We asked governance function respondents how they feel the demands on their team have changed since the implementation of the SMCR.

Governance: How would you describe the demands on your team have changed since the implementation of the SMCR?



58 per cent indicated that it had imposed a significant extra workload on the relevant functions and a number reported that they had made new hires specifically to manage that additional workload.

One respondent outlined the issue, indicating that the extra workload primarily impacted upon compliance and HR and related to applications, annual processes (e.g. conduct rule breach reporting, training and fitness and propriety assessments), assessment of SMCR-related regulatory developments and the implementation of any resulting changes.

Others referred to certification requirements, administration around senior manager applications, maintaining the MRM, and the need to develop new systems, processes and workflows to manage and maintain the SMCR approval process.

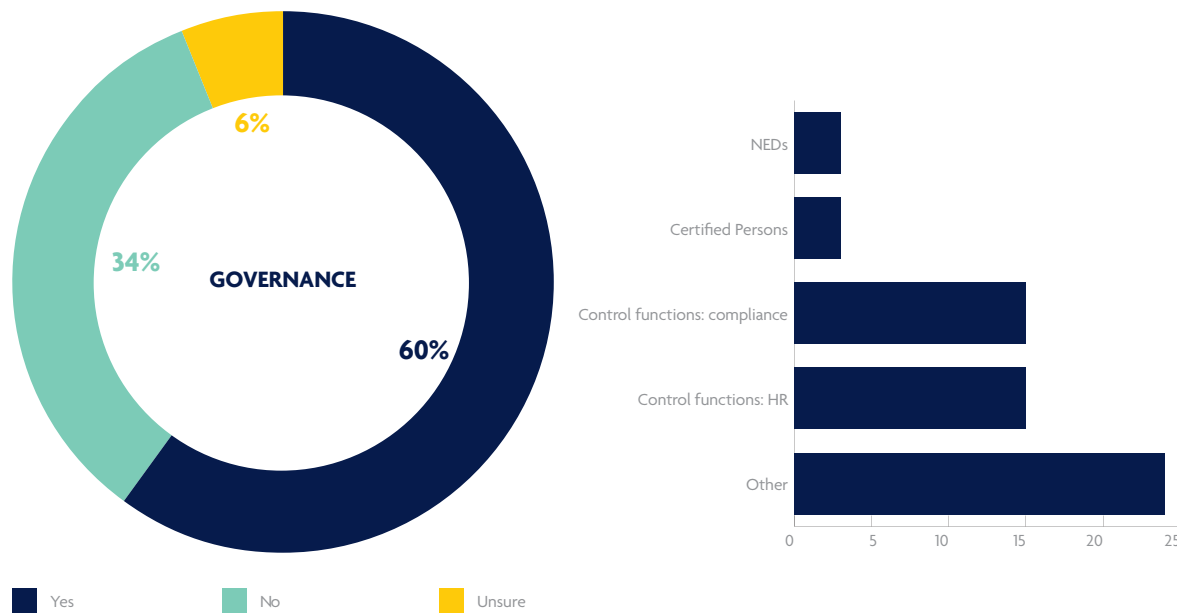
Only four per cent of the respondents said that the additional requirements had been subsumed in existing resources.

We asked specifically whether firms had hired new employees to support the SMCR process.

Some firms have created a dedicated team to manage SMCR requirements in the first line.

Some firms reported that they had recruited a significant number of new employees to assist with managing these processes.

Governance: Have you hired new employees to support the SMCR process?



42 per cent of governance function respondents reported that there had been no new hires to support the SMCR process.

19 per cent of the respondents had seen new hires in HR and a further 19 per cent had seen new hires in compliance. 31 per cent of respondents also reported that there were new hires in other functions within their firms. Contractors are also seen as a way to bridge any resource requirements. At one end of the spectrum, some respondents referred to dedicated new units/teams having been established for the purpose.

LEAVERS

62 per cent of governance function respondents indicated that they did not believe that the implementation of the SMCR had led to any employees leaving their respective firms. 12 per cent reported that there had been departures resulting from the SMCR implementation and the remainder were unsure. In some instances, failure to meet the certification requirement or gain necessary regulatory qualifications had meant that exiting employees could no longer continue to be employed.

None of the governance function respondents were aware of the SMCR having led to any relocation of staff. However, there are some instances where failure to pass certification or regulatory qualifications has meant that they can no longer be employed. There is no evidence of people leaving because they did not want to be subject to the SMCR rules and liability.

TRAINING

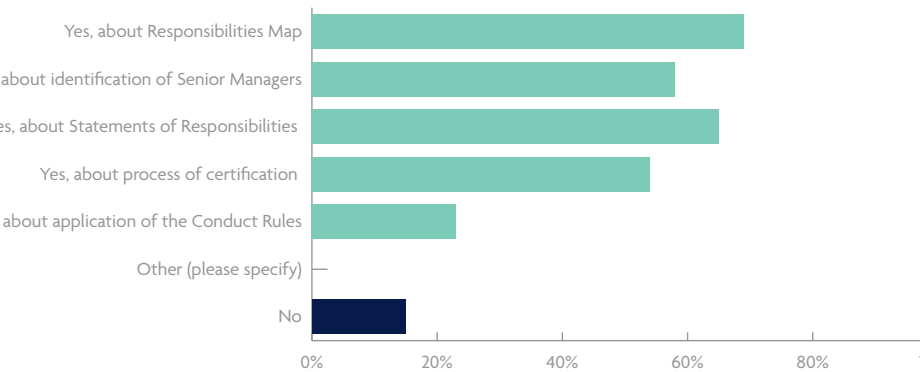
Apart from the observations already made concerning the SMCR training for senior managers both prior to and during their appointment, we asked the governance function respondents about whether they had undergone training in respect of the SMCR. 100 per cent of the respondents told us they had received training, a perhaps unsurprising but nevertheless reassuring statistic.

Regulatory focus on the SMCR

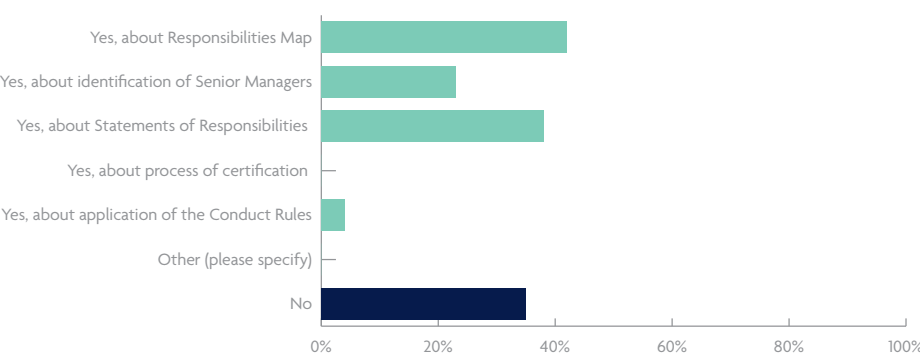
We also wanted to understand the extent to which the relevant firms had been engaging with the FCA/PRA in relation to the implementation of ongoing compliance with the SMCR.

Governance function respondents were asked whether the PRA or FCA had asked questions of their firms concerning SMCR implementation or ongoing compliance with the new regime.

Governance: Has the PRA or FCA asked you questions about your SMCR implementation process or ongoing compliance with the regime?



Governance: If yes, have you had to make changes to comply with the expectations of the PRA or FCA?



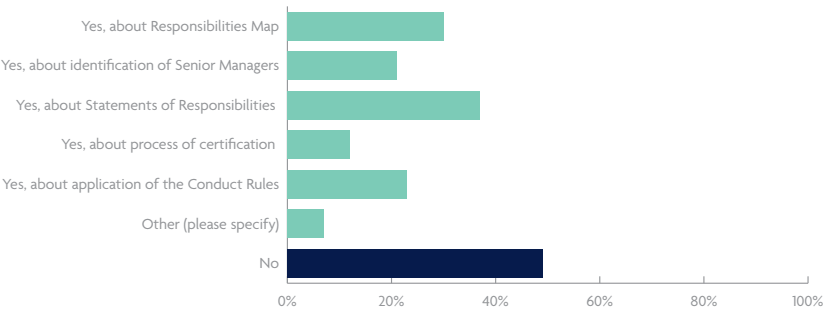
58 per cent indicated that they had received questions about the identification of senior managers. A further 65 per cent had received questions about senior managers’ SoRs and a further 54 per cent had been asked about the certification process. A lower number of just 23 per cent had been asked about the application of the conduct rules and finally, 15 per cent reported that they had no issues raised with them.

We also asked whether firms had to make changes to comply with the expectations of the PRA or FCA.

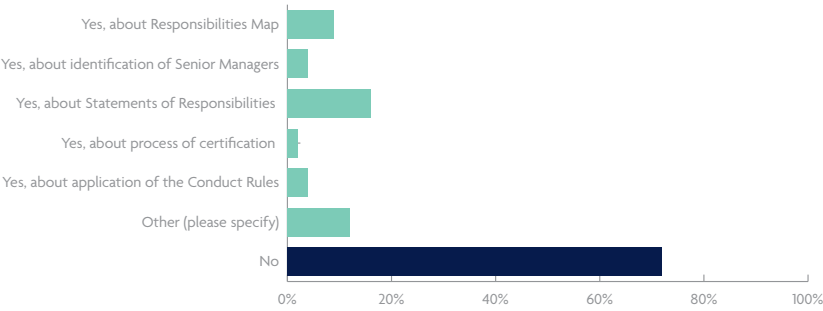
In terms of whether firms had made changes to comply with the expectations of the PRA or FCA, 42 per cent indicated that they had involved or made necessary changes in relation to the MRM. A further 23 per cent had made changes in relation to the identification of senior managers and 38 per cent had made changes in relation to SoRs.

Similar questions were raised with the senior manager respondents.

Senior managers: Has the PRA or FCA asked you questions about your SMCR implementation process or ongoing compliance with the regime?



Senior managers: If yes, have you had to make any changes to comply with the expectations of the PRA or FCA?



30 per cent indicated that questions had been raised about the MRMs, 21 per cent had been asked about the identification of senior managers, a higher 37 per cent had been asked about their SoRs and 12 per cent had been asked about the certification process. Meanwhile 23 per cent had been asked about the application of the conduct rules.

However, around half of senior managers (49 per cent) had not received any such questions from the PRA or FCA.

We also asked the senior managers whether they or their firms had to make changes to comply with the expectations of the PRA or FCA.

In relation to any changes made in response to the issues raised by the PRA or FCA, the relevant percentages were nine per cent to the MRMs, four per cent in relation to the identification of senior managers, 16 per cent in relation to SoRs and much smaller percentages in relation to the certification process and application of the conduct rules.

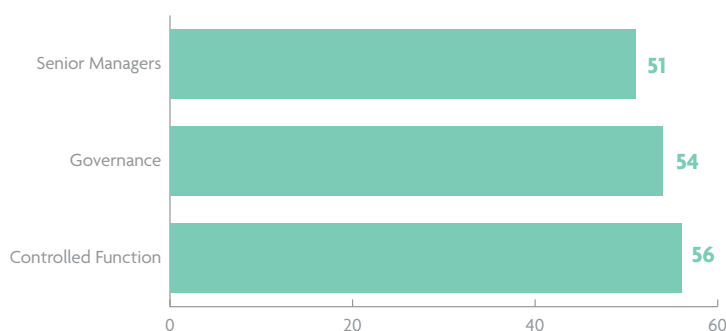
A significant 72 per cent reported making no such changes.

We also asked the governance function respondents whether the introduction of the SMCR had led to a greater consideration of Principle 11 notifications by their respective firms. 73 per cent of the respondents indicated that they did not believe it had done so, but a small but not insignificant minority of 27 per cent took the opposite view. Those who indicated that it had not had such an impact expressed confidence in their processes around making notifications under Principle 11, and were comfortable with the level of disclosure and transparency that they had with their regulators.

Burden of the SMCR

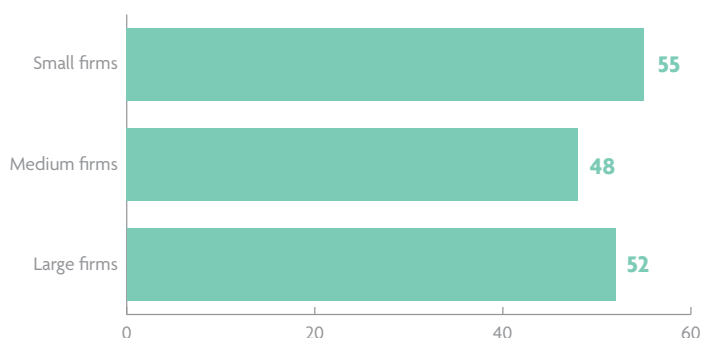
We asked each of the constituencies of governance functions, senior managers and control functions about their perception of the level of burden that the implementation of the SMCR had involved. The below graphic shows the extent to which each group considered implementation had imposed such a burden.

Senior managers, governance and control functions: How burdensome do you consider the SMCR rules are for your firm?



The mean averages of the reported burden imposed by the SMCR implementation are remarkably similar across respondents who were senior managers, governance function and controlled functions (51, 54 and 56 out of 100, respectively).

How burdensome do you consider the SMCR rules are for your firm?



The smallest firms in our survey tended to experience the highest burden associated with SMCR compliance. Firms with a UK headcount of less than 500 people reported, on average, a burden of 55 out of 100, compared with 48 out of 100 for firms with 500 to 5,000 staff, and 52 out of 100 for firms with a headcount of over 5,000. This suggests that the SMCR places a disproportionate burden on smaller firms with fewer resources to comply with the same rules as the largest firms. Our recommendation of introducing a proportionate application of the SMCR requirements would, we consider, go some way in addressing this issue.

RECOMMENDATION

(see Recommendation 1)

We found the SMCR has not led to an exodus of people from the industry, with little evidence to suggest that people have left or relocated to avoid the impact of the SMCR. Indeed, some firms have bulked up on resources to support SMCR compliance.

There is otherwise little evidence that recruitment of senior managers is any more difficult or costly since the SMCR was implemented. However, firms do consider the burden of complying with the SMCR is significant in terms of resources.

With the latter point in mind, we would repeat our recommendation concerning a level of proportionality being required in respect of different scales/types of banks

CONCLUSION

Three years on from the introduction of the Senior Managers and Certification Regime and it is clear that the banking industry has undergone a notable evolution as a result of the reforms.

While good governance and culture have been major areas of focus since the financial crisis, this report highlights just how deeply embedded they have become to the way that the banking industry and those working in it now operate.

Significant progress has been made to ensure that there is clarity of accountability within firms and their senior managers, as our report shows. Our report evidences considerable structural and procedural change within firms to ensure the ongoing operational consistency with the objectives of SMCR, as well as significant resource allocated to day to day compliance. There is also a clear commitment to the core documents introduced by the SMCR, such as SoRs, MRMs and handover certificates.

Firms and their senior managers have also made substantial progress to ensure that the behaviour of all individuals within firms adheres to the highest standards of any industry, with key tools such as certification, regulatory references and conduct rules being actively used to achieve this.

However, as the SMCR becomes further established, there is evidence of some unintended consequences as a result of the regime. These include a divergence of approach to the classification of conduct rule breaches and an emerging zero tolerance approach to the recruitment of candidates who have any disclosures – even minor disclosures – made against them. Importantly, our recommendations make specific and practical suggestions which we believe could be considered and adopted to further improve the efficiency and effectiveness of the SMCR for both firms and senior managers in the future.

This report is intended to provide general information only and is not intended to be comprehensive or to provide legal, regulatory, financial or other advice to any person.

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