New Risks - the New Senior Manager and Senior Insurance Manager Regimes

New Regime for UK Banks & Insurers from January and March 2016

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From 7th March 2016 (and 1st January for insurers), a new regulatory financial services regime will be in place in the United Kingdom. The new regime is significant; it is intended to make it far easier for UK regulators; the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA), the two authorities which took over from the FSA in 2013, to hold the senior executives of banks and other financial institutions to account when there are regulatory and other breaches and, as a result, to bring about a wholesale change of culture.

Why the new regime is being introduced?

Like much of current financial services regulatory reform, the new regime has its genesis in the 2008 financial crisis and, particularly, a perception that senior executives have not been held to account for mistakes made. There is, therefore, a very political backdrop to the new regime, which follows on from and implements many of the recommendations of the Parliamentary Commission on Banking Standards and is underpinned by the Financial Services (Banking Reform Act) 2013. The Governor of the Bank of England, Mark Carney and the heads of the PRA and FCA have been very clear as to what the new regime is intended to achieve. In a major speech, earlier this summer, Mark Carney referenced the need to hold senior individuals to account and to *"reserve the tide of ethical drift"*. As a result of the new regime he indicated that, *"the age of irresponsibility is over"*.

Who is caught?

The new regime will apply to UK incorporated banks, building societies, credit unions, and PRA designated investment firms in the UK "SMR" (Senior Managers Regime). Insurers and reinsurers are subject to the "SMIR" (Senior Managers Insurers Regime). It will also apply to branches of foreign banks and insurers.

How the new regime will work?

For banks, building societies and credit unions and PRA designated investment firms. There are three streams to the new regime; the introduction of a new Senior Manager's Regime imposing strict new responsibilities on the most senior executives, the introduction of a new Certification Regime imposing obligations on financial institutions to assess and certify their staff's fitness and propriety on an annual basis and the introduction of new Conduct Rules to apply to all staff, save for some carrying outlimited ancillary roles. For insurance companies SIMR will replace the current Approved Persons Regime.

The Senior Manager's Regime – Allocation of Responsibilities

The Senior Manager's regime works through the PRA and FCA, prescribing certain Senior Management Functions (SMF's) and Prescribed Responsibilities to be undertaken by those functions. The first task for organisations, subject to the Regime, is to identify who will be carrying out the Senior Manager Functions and then, to assign all prescribed responsibilities amongst Senior Management Functions. Having done this, organisations are required to record the allocation of responsibilities to individual Senior Managers through the production of "Statements of Responsibilities" designed to provide a record of exactly what each senior manager is responsible for. Organisations are then required to summarise these within a Responsibilities Map for the organisation as a whole, this map being designed to show exactly who is responsible for what.

For insurance the SIMR will apply to senior insurance managers who are subject to pre-approval by the PRA for a controlled function together with all other senior persons who have responsibility for key functions and who need to be assessed as being fit and proper by the PRA. SIMR applies from 7th March 2016 and some parts from 1st January 2016.

The Senior Managers Regime – The Presumption of Responsibility and Approach to Enforcement

Aside from the allocation and recording of responsibilities, the key provision is a presumption of responsibility; such that, where there has been misconduct, the Senior Manager responsible for the activities, where the breach occurred will be guilty of misconduct, and, in order to avoid individual liability, it will be incumbent on them to satisfy the relevant UK regulator (the PRA or FCA as appropriate) that they have:

> *"taken such steps as a person in their position could reasonably be expected to have taken to avoid the breach".*

The UK regulators have also made clear that they intend to apply an approach to enforcement where they will focus on taking action against individuals.

> *"the FCA has emphasised the importance of holding senior individuals to account, in order to support its policy of credible deterrence and to bring about a change in culture".*

For SIMR Insurers Executives will not be subject to a presumption of responsibility or the new criminal offence. There is therefore not a reverse evidentiary burden. There is still however emphasis upon the importance of clear individual accountability.

The Certification Regime

The Certification Regime will replace the current Approved Persons Regime. It will apply to staff, other than Senior Managers, who could pose a risk of significant harm to the firm or its customers. It will place more of an onus on firms themselves to assess and satisfy themselves of staffs' ongoing fitness and propriety for carrying out their role.

For SIMR there is no certification regime rather a Solvency II[1] requirement for insurers to assess the ongoing fitness and propriety of individuals performing key functions.

The New Conduct Rules

The last part of the regime is new conduct rules. The new conduct rules will also apply from 7th March 2016 in relation to senior managers and staff caught by the Certification Regime. There will be a further year before the new conduct rules apply to more junior staff. There is also a positive obligation on firms to take all reasonable steps to ensure that staff understand how the new conduct rules will apply to them; effectively imposing an obligation to train staff on the new rules.

For both the SMR and SIMR conduct rules require that any delegation of responsibilities is to an appropriate person and is properly overseen. There is a positive obligation to whistleblow to the regulators and for bank executives there is also a new criminal offence of taking a decision causing financial institution to fail.

The Detail

The final rules are detailed in FCA Consultation Paper CP15/22 published in July the year. Further detail regarding the application to foreign branches of banks can be found at FCA Consultation Paper FCA 15/10 published in March this year, and policy statement PS 20/15 published on 13th August. Details regarding application to the insurance sector are within PRA Policy Statement PS 3/15 and PS 13/15 published in March this year PRA Constitution Paper CP 26/15 and Policy Statement PS 21/15 published 13 August 2015.

Practical Impact

The new regime is intended to bring about a wholesale change in culture within Banks, Insurers and other financial institutions by giving the most senior executives a very real practical incentive (given an understandable wish to avoid regulatory action being taken against them personally) to ensure full compliance with financial services regulation and, as part of this, to ensure an appropriate culture throughout the organisation. Between now and March, there is a lot of work for organisations to do in ensuring appropriate grandfathering of those who will take on Senior Management Functions in the new regime, production of Statements of Responsibilities and Responsibilities Map and also ensuring, as part of putting this in place, a thorough analysis is carried out of all risks and steps to mitigate those risks. Further work is also required in getting ready for the new Certification Regime, including ensuring processes are in place for annual certification, and providing training on the new conduct rules.

For foreign banks operating in the UK the new regime will apply either to the appropriate UK banking legal entity or branch entity in the UK. EEA branches, i.e. branches of banks the head office of which is based in an EEA (European Economic Area) country, are caught in a more limited way than non-EEA branches, the head office of which is outside of the EEA. This is because under EU law certain regulatory functions are the responsibility of the Home State Supervisor; i.e. the supervisor in the country where the head office is based. For branch entities the overall scheme applies as described above albeit with a reduced list of prescribed responsibilities and similarly therefore, senior management functions. One key issue for UK entities or branches will be the potential for group senior executives, based outside the UK, to be caught by the new regime as a Group Entity Senior Manager responsible for the conduct of UK regulated activities. No doubt there will be a significant focus on seeking to ensure that this is, as far as possible, avoided.

For insurers and reinsurers we have a checklist and further advice available for Governance maps and Group Entity SIMF.

Key dates for SIMR include:

(a) 1st January 2016

(i) Firms must have governance maps in place and scope of responsibilities applications made.

(b) 8th February 2016

(i) Submit grandfathering notifications to PRA and FCA (SIF) holders.

(c) 7th March 2016

(i) New conduct rules apply to PRA and FCA approved persons.

(d) 7th September 2016

(i) Submit scope of responsibilities forms for grandfathered individuals;
(ii) Submit notification forms for transitional key function holders given in 1st January who are not grandfathering.

Where the financial institution be it Banks or Insurers is based overseas for example the United states of America and has UK subsidiaries this new regulatory regime has implications for senior executives, those persons carrying out Senior Management functions, key functions and other responsibilities as defined who might move to the UK subsidiaries as part of the US or overseas Banks global strategy. Therefore the regime does have an extraterritorial application in this very practical sense.

Endnotes

1 Solvency II is an EU Directive that codifies and harmonises EU insurance regulations primarily in respect of capital to be held against the risks profiles of the companies or entities concerned and to ensure a uniform and enhanced level of policyholder protection

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