Hedge Fund Law Report
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The U.K. Senior Managers Regime: Responsibilities of Senior Managers (Part One of Two)

Apr. 25, 2019
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The U.K.'s Senior Managers and Certification Regime (SMCR), which took effect for the banking industry in 2016, will be applied to the rest of the financial services industry from December 9, 2019. The SMCR introduces a heightened level of personal responsibility for senior managers, shifts the duty to certify control function staff onto regulated firms and establishes rules of conduct for all financial staff.

A recent ACA Compliance Group (ACA) webinar provided a roadmap for navigating the transition to the SMCR. The program, entitled "Senior Managers & Certification Regime: What You Need to Know," featured Martin Lovick, ACA senior principal consultant; Josie Cooper, ACA consultant; and Dimitrios Sachinidis, ACA senior compliance analyst. This article, the first in a two-part series, summarizes the panelists' insights on the genesis and extension of the SMCR, as well as the responsibilities of senior managers. The second article will explore the firm-based certification of certain other personnel (Certification Regime), the imposition of rules of conduct on virtually all firm employees (Conduct Rules) and steps fund managers can take toward compliance.

See "FCA Issues Guidance on Expansion of Senior Managers Regime to Fund Managers and Others" (Feb. 1, 2018); and "Hedge Fund Legal Personnel May Fall Under U.K. Senior Managers Regime" (Feb. 4, 2016).

Genesis and Extension of the SMCR

The SMCR arose out of general frustration over the 2008 financial crisis and a desire to "find someone to blame for what had happened," Lovick explained. Financial firms treated penalties simply as a cost of doing business. Moreover, when the U.K. Financial Conduct Authority (FCA) did seek to hold individuals accountable, it was unable to "pierce the cloak of collective responsibility within most structures," he said.

The SMCR has three main components: FCA approval of senior managers of financial firms, the Certification Regime and the Conduct Rules. The SMCR is intended to reduce harm to consumers and strengthen the integrity of the market by:

- fostering a "culture of responsibility";
- prescribing individual responsibilities; and

- holding senior managers accountable when things go wrong.

See "FCA Chief Executive Touts Senior Managers Regime and Remuneration Restrictions As Important Incentives to Promote Good Culture at Fund Managers" (Apr. 12, 2018); and "FCA Director Emphasizes Regulator's Focus on Firm's Culture of Compliance" (Jul. 21, 2016).

The SMCR has applied to the banking sector for almost three years, Lovick noted. Its extension to all firms regulated solely by the FCA takes effect on December 9, 2019. Regulators and practitioners have had considerable experience with the regime, and its extension to the broader financial services industry is generally considered to be "proportionate," he said. Firms with a "reasonably robust governance structure" are probably already doing most of what is required and should have nothing to be alarmed about. Nevertheless, the FCA is expected to bring enforcement actions under the SMCR promptly, Lovick cautioned.

See "FCA Director of Enforcement Details the Goals and Tenets of the Agency's Senior Managers Regime and Proposed Modifications to Its 'Early Settlement' Program" (Feb. 16, 2017); and "FCA Enforcement Director Emphasizes Responsibilities Under Senior Managers Regime" (Jun. 2, 2016).

Duties Depend on Firm Type

A firm's duties under the SMCR depend on whether the firm is deemed to be a "core," "enhanced" or "limited-scope" firm, Cooper said:

- Core firms are subject to the baseline requirements of the SMCR.
- Enhanced firms (*i.e.*, investment managers with more than £50 billion in assets under management) have duties more like those currently applicable to banks under the SMCR.
- Limited-scope firms will be subject to an "SMCR-light" approach, with fewer requirements. Limited-scope firms will include small consumer credit firms, sole traders, professional firms whose only regulated activities are non-mainstream and authorized internally-managed alternative investment funds.

When the SMCR takes effect, individuals approved by the FCA to perform certain controlled functions (CFs) under the existing Approved Persons Regime (APR) will automatically be transferred, or "mapped," to corresponding Senior Management Functions (SMFs) under the SMCR.

Authorized Representatives

The SMCR will not extend to authorized representatives (ARs), Cooper continued. ARs will continue to be subject to the APR, and approved persons of ARs will continue to be registered under their existing CFs. The FCA is considering extending the SMCR to ARs, however. Principal firms of ARs will be subject to the SMCR and will remain responsible for their ARs' compliance with all regulatory requirements.

Non-U.K. Entities

The SMCR does not change the fundamental legal requirements for U.K. affiliates of U.S. asset managers, but it does change "the balance in respect of managers of the parent entity who play a significant role in the management of the U.K. firm," Cooper explained. The provisions applicable to senior managers have no territorial limitation; therefore, they apply to anyone who plays a senior management role in the U.K. regardless of where that person is based. On the other hand, the Certification Regime is limited to individuals who are either based in the U.K. or deal with or have contact with U.K. clients. "Material risk takers" are always subject to the Certification Regime, however, regardless of where they are located.

The SMCR will also apply to both European Economic Area (EEA) and third-country branches, Cooper said. It will apply even in the event of a "hard" Brexit. There are additional requirements applicable to firms with branches, which differ depending on whether the branch is in the EEA or in a third country.

Senior Managers

The SMCR requires firms to identify senior managers, define their roles clearly and make them accountable for their actions, Cooper explained. The SMCR replaces the current governing and required functions section of the APR. Senior managers must be approved by the FCA prior to performing their duties. An individual can hold multiple senior manager functions. The 12-week rule for temporary absences will continue to apply for senior management functions.

Many existing Significant Influence Functions (SIFs) under the APR will map automatically to the SMCR with no additional action required, unless a change in role is desired, Cooper added. These include:

- CF1 Director to SMF3 Executive Director;
- CF3 Chief Executive to SMF1 Chief Executive;
- CF4 Partner to SMF27 Partner;
- CF10 Compliance Oversight to SMF16 Compliance Oversight; and
- CF11 Money Laundering Reporting Officer to SMF17 Money Laundering Reporting Officer.

The current CF2 Non-Executive Director function does not automatically map to an SMF, Cooper noted. A CF2 must only register and be approved for an SMF if he or she is the chair of the governing body of the firm. The CF28 and CF29 functions will fall away; those individuals will probably be subject to the Certification Regime.

Individuals automatically mapping to SMFs are not required to provide references or undergo criminal background checks when the SMCR comes into force, Cooper added.

Limited Liability Partnerships

The SMCR will have an impact on U.K. limited liability partnerships (LLPs), Cooper noted. The FCA recognizes that some junior partners have virtually no roles in management. Under the APR, each partner must be approved as a CF4. Under the SMCR, a CF4 will only be required to map to a SMF27 if his or her day-to-day role includes firm management. Therefore, an LLP with CF4s that do not participate in management can submit a Form C to the FCA prior to the commencement date of the SMCR to cancel their current approvals.

Prescribed Responsibilities

The SMCR designates certain "Prescribed Responsibilities" (PRs) that firms must assign to senior managers, Cooper explained. Core firms must assign responsibility for:

- implementation and oversight of the firm's duties under the Senior Managers Regime;

- performance of its obligations under the Certification Regime;
- notification and training regarding the Conduct Rules;
- responsibility for policies and procedures to counter the risk of financial crime; and
- compliance with the Client Assets Sourcebook, if applicable.

In addition, authorized fund managers must assign responsibility for their "value for money" assessments and independent director representations, as well as when acting in the best interests of investors. Enhanced firms are subject to seven additional PRs, Cooper said.

A PR should be assigned to the most senior person in the relevant area. That person must have sufficient authority and appropriate knowledge and competence, Cooper continued. PR allocation will depend on a firm's size and structure and the breadth and types of roles performed by its managers. The goal is to allocate PRs across the senior management team. The FCA cautioned that a firm should not assign too many PRs to a single person. The FCA also recognized that, in some cases, a PR can be shared, but it should be rare and justified by the circumstances.

Each senior manager must be given a written Statement of Responsibility (SoR) that makes clear what PR he or she has been assigned, Cooper continued. An SoR must be clear and succinct; contain no unnecessary details; and refer to no other documents. Unlike a job description, an SoR should be a broad statement of the manager's regulatory responsibilities, rather than a detailed list of his or her day-to-day duties.

Each manager with an existing SIF that maps automatically to an SMF must also have an SoR, but there is no need to submit it to the FCA, Cooper noted. After the SMCR takes effect, a firm must provide an SoR with each Form A application. When appointing a new senior manager, a firm must supply the FCA with the manager's induction program; field gap analysis; learning and development plan; and an explanation of "how the competence of that individual was assessed," she said. A firm must keep all SoRs up to date and resubmit them when there is a significant change, such as a reassignment of a PR from one manager to another. When a manager has multiple PRs, only one SoR is needed, which must cover all of his or her PRs.

Individuals presently carrying out PRs are not automatically deemed to be performing senior manager functions. Thus, "PRs can be allocated to individuals who do not hold senior manager functions," Cooper added.

Duty of Responsibility

Every senior manager is subject to a "duty of responsibility," Cooper explained. If a firm breaches a regulatory duty, the senior manager responsible for that function can be held accountable if he or she did not take reasonable steps to prevent or stop the breach.

The FCA expects managers to keep appropriate records – the "what, why and when" – of their key decisions, Cooper added. In light of the increased risk of personal liability created by the duty of responsibility, firms should consider reviewing the scope of their existing director and officer liability insurance coverage.

See "U.K. Imposes New Statutory Duty of Responsibility on Hedge Fund Senior Managers" (Oct. 22, 2015).

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