Society of Insurance Broking

Standards. Professionalism. Trust.

Good Practice Guide

September 2018

Senior Management & Certification Regime for Brokers

Foreword

Liz Foster

Non-executive Managing Director of the Society of Insurance Broking

Earlier this year, we told brokers that the FCA had plans to create a new regime to make them more accountable.

"Hang on," one of them said, "every time my clients make a claim, I'm there to help them – and every time their cover comes up for renewal, I help them find a good deal. How much more accountable can you be?"

The good news is that the FCA understands this. It is true that the FCA is replacing the Authorised Persons Regime with the new 'Senior Management and Certification Regime' to create consistency across banking, investment, personal finance and insurance. However, it has stressed that it wants the new regime to reflect what brokers already do to make themselves genuinely accountable to their clients, and not to create a cottage industry in corporate governance.

The FCA has said, "We… want the regime to be as simple as practicable for firms to understand and implement", and it really means this.

It has also said, "the SM&CR doesn't require firms to change their governance structure or hire new people to fill specific roles… **However, individual Senior Managers have an important part to play in establishing and embedding the right culture and governance within firms, to improve the standard of conduct at all levels.**"

This is the real test of SM&CR. If firms are organised in the right way – with the right people and incentives in place to deliver the best outcomes for customers – then issues around reporting largely look after themselves.

Sitting in front of clients and explaining how your recommendations are working for them, year after year, is far more demanding. If your firm can pass this test, complying with the new senior management regime will be straightforward.

Introduction

What is the SM&CR?

The Senior Managers & Certification Regime (SM&CR) is a programme designed by the FCA to improve 'trust in financial services' by making the right people in financial services firms accountable for their decisions.

The programme originally came about in response to the 2008 financial crisis where it was felt that not enough action was taken against the banking sector. The SM&CR originally applied to banks and building societies in 2016 and is now being extended to include brokers, financial advisers, fund managers, insurers and reinsurers.

As Andrew Bailey, Chief Executive of the FCA, said:

"Trust in financial services will only be rebuilt when the public truly believe that senior managers in our financial institutions are taking responsibility for the actions they take."

As a result, much of the SM&CR focuses on:

- Who the senior managers are in a firm;
- What they are taking responsibility for; and
- What happens if they fall short of their responsibilities.

The SM&CR comes into effect for solo-regulated firms from 9 December 2019 and will replace the Revised Approved Persons Regime (it will not apply to Appointed Representatives). There are also two transitional provisions to help firms move to the new regime:

- Firms must identify their Certification Staff before the Commencement date of 10 December, but will have 12 months afterwards to complete the initial certification process; and
- Senior Managers and Certification Staff must be identified and trained on the Conduct Rules by the Commencement date, but firms will have 12 months to train their other staff.

Identifying Senior Managers within the firm

The FCA cannot oversee the hundreds of thousands of people who work in financial services. As a result, it has split those who work in financial services into three groups according to staff seniority and exposure to the public:

- **Senior Managers:** these are the people who the FCA will spend the most time overseeing 'Senior Management' Functions (SMFs), namely chief executives, executive directors, and other executive and overall responsibility functions. This will vary by size of firm – and for very small firms can be just one person.
- **Significant Harm Functions (SHFs):** for SMF-holders whose roles "are deemed capable of causing significant harm to its customers". It will primarily be the role of the firm to oversee these people and issue them with a certificate every year to confirm that they are fit and competent to do their role. Although the FCA will not oversee these people directly, the system of certification will allow the FCA to identify very quickly who was delegating authority to them, and whether they were delegating that responsibility in an appropriate way. Because of the importance of the certification process, these individuals are often referred to as 'certified individuals'.
- **Other staff:** all other employees except 'ancillary staff' (post room, security guards, etc). These are staff that are unlikely to cause significant harm to customers. It is the responsibility of firms to ensure they behave in a competent and ethical way by creating a strong organisational culture.

Identifying Senior Managers within the firm

Responsibilities for **senior managers** are significant, and require a demanding compliance structure:

- Requirement for prior FCA approval: for each person appointed to perform one or more SMF, before the person takes up the function. An 'overlap rule' will be applied in the case of when more than one SMF is to be held by the same person (approval needs to be granted for each individual function on the same application);
- Statement of responsibilities: setting out which aspects of the firm's affairs that person will be responsible for managing. For larger firms, a 'management responsibilities map' will show details of reporting lines, including how SMFs have been allocated;
- Allocation of prescribed responsibilities: there is a long list of prescribed responsibilities, such as compliance with regulatory requirements, and training and professional development; finally, there is a new provision, the:
- Duty of responsibility: this requires senior managers to take reasonable steps to prevent poor outcomes for customers. It means that senior managers can be punished for things they should have done but did not do, as well as being punished for things they actively did wrong.

Certified individuals undertaking SHFs will need to meet certain requirements in order to be issued with a fit and proper certificate, which is valid for 12 months. It indicates that the employee is assessed in terms of honesty, integrity, reputation, as well as whether the person has the necessary qualifications, training, competence and personal characteristics to perform their role.

When firms are allocating responsibilities to individuals, they only need to have SMFs for duties they currently have. They do not need to hire extra staff to fill roles that otherwise do not currently exist.

When certified individuals move from one role to another, the previous employer(s) must give a regulatory reference. The FCA expects that any misconduct that led to formal disciplinary action will be included in a regulatory reference. As a result, misconduct by certified individuals can have a very significant impact on their career.

Conduct Rules

This applies to all other staff, except what SM&CR calls 'ancillary staff'. It comprises a variation of the FCA Approved Person regime that firms adhere to already, and CII members will see compatibility with the CII's Code of Ethics. The FCA proposes to create two tiers of Conduct Rules: those for most employees within the firm (except ancillary staff), and those for senior managers:

- **Individual Conduct Rules**
  - You must act with integrity.
  - You must act with due skill, care and diligence.
  - You must be open and cooperative with the FCA, the PRA and other regulators.
  - You must pay due regard to the interests of customers and treat them fairly.
  - You must observe proper standards of market conduct.
- **Senior Manager Conduct Rules**
  - You must take reasonable steps to ensure that business [you are running] is controlled effectively.
  - You must take reasonable steps to ensure that the business [you are running] complies with relevant requirements and standards of the regulatory system.
  - You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
  - You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

What happens if individuals fall short of their responsibilities?

The SM&CR is designed to place a greater importance on accountability rather than just imposing fines. By making individuals personally accountable for their actions, the SM&CR aims to promote a 'Duty of Responsibility' that encourages self-governance and ethical behaviour.

If an individual does breach a Conduct Rule, then their firm must notify the FCA once disciplinary action has been taken. SMF holders must notify the FCA within 7 business days of concluding the disciplinary action. The FCA will then maintain a public Financial Services Register, 'the FS Register', with only approved firms and individuals appearing on the published list. Under certain circumstances it may be appropriate to take action against both the individual and the firm.

The criteria of how the FCA will discipline individuals, or those that fail to report their actions, is outlined in the Decision and Procedure and Penalties Manual (DEPP) (https://www.handbook.fca.org.uk/handbook/DEPP.pdf). However types of disciplinary action can be summarised as:

- Issuing of a formal written warning;
- Suspension or dismissal of a person; or
- Reduction or recover of remuneration.

Good Practice

1. Think about customer outcomes first

The SM&CR is only a means to an end – increasing trust in the industry by reducing harm to consumers. Therefore, the best way to start with the SM&CR is to think about the risks that your clients face and how you help prevent them from harm. For example, what due diligence do you take to make sure that business is placed with a provider that is not only competitive on price, but also on other factors such as financial strength or quality of cover and service (especially at the claims stage)? It is important for the owner or the board of the business to ask, who is responsible for this analysis? How is it updated? Who is responsible for maintaining these processes? Are there any potential conflicts of interests? How do we gather feedback from clients? Who is responsible for acting on that feedback?

Once you have a clear picture of the risks your clients face, establish who in your firm is identifying and managing those risks, and how close the firm is to its clients' experiences.

2. Think about creating the right culture

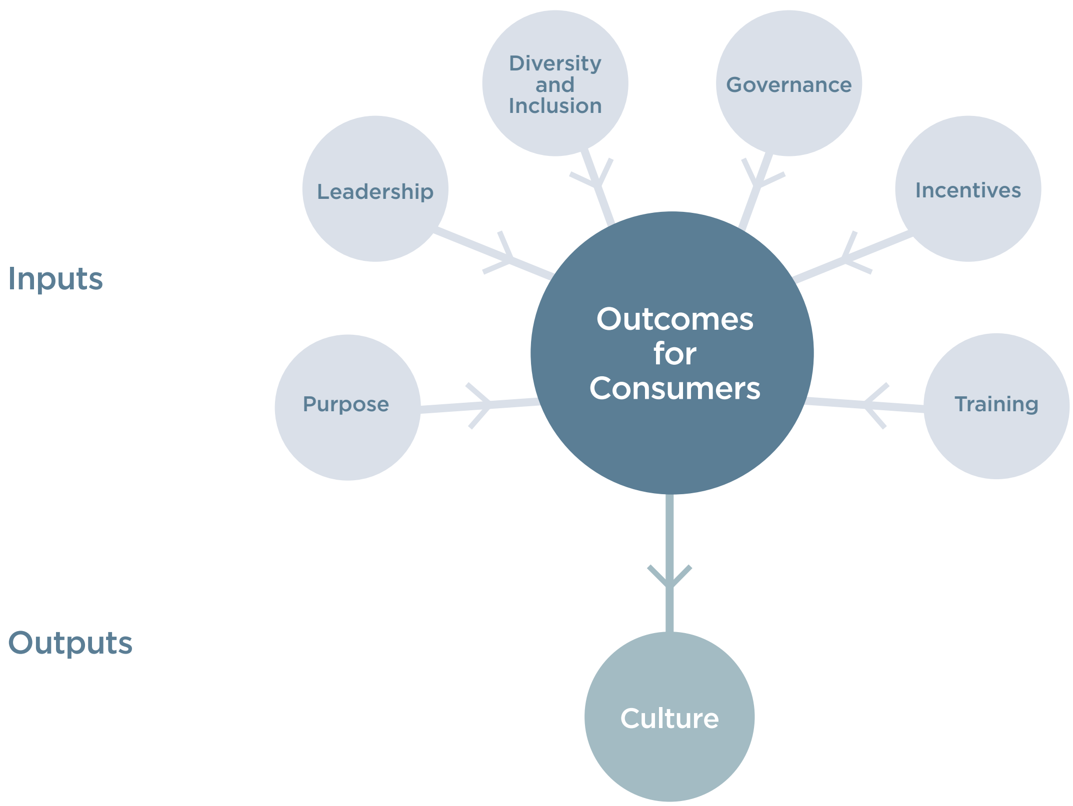
Processes on their own are not enough to prevent harm – creating good outcomes for customers involves individuals behaving in a competent and ethical way, day in and day out. This can only be done if the culture of the firm is focused on doing the right thing over the long term – not just doing what it takes to survive until tomorrow.

The FCA has encouraged firms to think about a strong organisational culture as an output. The inputs that managers have control over include:

- its purpose;
- the way it is led;
- its governance processes and incentives; and
- the diversity of people who work with it (especially as firms grow).

The crucial point is that all these inputs have to add up to good outcomes for consumers. A firm has to reflect the interests of the clients it serves. By creating a better organisational culture they are better equipped towards truly understanding and providing for their customers. No firm can say, "we have a great culture, even though our clients don't always get what is in their best interests".

The relationship between culture and inputs are summarised in this diagram:



3. Don't get bogged down with who's in which pigeonhole

Once you have thought about how you deliver good outcomes for customers, deciding who should be senior managers and who should be certified individuals should be relatively straightforward.

You should aim for the right balance between concentrating accountability and building a comprehensive view of the organisation. The best presentation is one that shows ultimate accountability being concentrated in a small number of individuals.

Spreading accountability over a wide range of individuals will leave the regulator asking, "who is really in charge here, and how can the executive team really control a large population of people who are all capable of causing significant harm to consumers?". There are no prizes for the firm that has the largest population of senior managers or certified individuals.

4. Keep up to date

Firms need to make sure that all members of staff with any involvement in the insurance aspects of the business comply with the code of conduct. However, the best tools to address this with are training, people management and by building a strong organisational culture. The tools used for concentrating accountability are not necessarily the tools that should be used for disseminating good practice.

By remaining on top of the list of PRA conduct standards, you will now be able to track and measure the progress of your staff as well as understanding when someone undertaking SHFs are not meeting their requirements. By certifying individuals as 'fit and proper' every 12 months basis you will be able to monitor whether the firm is being run efficiently and ethically on a more regular basis. The certification will not just apply to the employee's honesty, integrity and reputation, but also whether they are up to date with their training, qualifications and general competence.

5. Make sure you are covered

Always expect the unexpected. Unforeseen circumstances and last minute changes can affect every firm, which is why you always need to maintain your resilience:

The 12-week rule

If a senior manager is unexpectedly absent (eg sickness, personal emergency), you are allowed to appoint a temporary replacement, for up to 12 weeks, without needing approval from the FCA.

Outsourced roles

If your firm relies on a third party for the operational functions of the firm, your firm is still fully responsible for carrying out all of its regulatory obligations. While you may outsource the function, you can't outsource accountability for this function.

References

You are now required to obtain references from current and previous employers of at least 6 years for senior managers and those fulfilling SHFs. This will give you more peace of mind in ensuring that adequate background checks are taken. When providing a reference, you should also use a standard template, disclosing any relevant information covering the previous 6 years, assessing whether the candidate is fit and proper for the new role.

Conclusion

Some experts are already saying that the SM&CR will revise senior executive behaviour. It could encourage them to go straight to the FCA, rather than via the normal compliance channels, in order to mitigate risk of retribution if a firm is found to be in breach. This suggests a fundamental change of approach. It could help the FCA be more receptive to whistleblowers contacting the regulator directly.

By clearly outlining levels of responsibility, the SM&CR will make it easier not just to identify areas of market abuse or insider dealing, but also to create a culture that promotes the fair treatment of customers. Aligning insurers with the banking sector in this way will give customers greater confidence that a consistent and regulated system is in place.

By placing equal importance on the responsibilities of senior managers as well as conduct, this will be an important step in improving public trust.

Appendix – Primary Source Material

Financial Conduct Authority

Date	Name	Summary	Link
July 2017	CP17/25	Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms	https://www.fca.org.uk/publication/consultation/cp17-25.pdf
July 2017	PS18/14	Extending the Senior Managers and Certification regime to FCA firms – Feedback to CP17/25 and CP17/40, and near final rules	https://www.fca.org.uk/publications/policy-statements/ps18-14-extending-senior-managers-certification-regime-to-fca-firms
December 2017	CP17/40	Individual Accountability: Transitioning FCA firms and individuals to the Senior Managers & Certification Regime	https://www.fca.org.uk/publication/consultation/cp17-40.pdf
December 2017	PS18/16	The Duty of Responsibility for insurers and FCA solo-regulated firms	https://www.fca.org.uk/publications/policy-statements/ps18-16-duty-of-responsibility
December 2017	CP17/42	The Duty of Responsibility for insurers and FCA solo-regulated firms	https://www.fca.org.uk/publication/consultation/cp17-42.pdf
July 2018	The Senior Managers and Certification Regime: Guide for FCA solo-regulated firms	Senior Managers and Certification Regime: solo-regulated firms	https://www.fca.org.uk/publication/policy/guide-for-fca-solo-regulated-firms.pdf

HM Treasury

Date	Name	Summary	Link
October 2015	Policy paper	Senior Managers and Certification Regime: extension to all FSMA authorised persons	https://www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorised-persons

Prudential Regulation Authority

Date	Name	Summary	Link
December 2017	CP28/17	Strengthening accountability: implementing the extension of the SM&CR to insurers and other amendments	https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2017/cp2817
December 2017	CP28/17 – Appendix 3	Draft SM&CR forms	https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2017/cp2817app3
February 2018	PS1/18	Strengthening individual accountability in insurance: optimisations to the SIMR	https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/february/ps118