

Client Update

Bank of England and Financial Services Bill Extends Senior Managers and Certification Regimes to All UK Regulated Financial Services Firms

LONDON

Jeremy G. Hill
jhill@debevoise.com

Edite Ligere
eligere@debevoise.com

INTRODUCTION

On October 14, 2015, the UK Treasury's Bank of England and Financial Services Bill (the "Bill") had its first reading before the House of Lords. The Bill includes, amongst other things, an overhaul of the current Approved Persons Regime ("APR") as proposed by the UK financial services regulators, the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA"). The Bill, however, made some far-reaching changes to the regulators' proposals.

These changes include: (i) removing the presumption of responsibility from the Senior Managers Regime; (ii) extending the Senior Managers and Certification Regimes (together, "SMCR") to all regulated financial firms, not just those in the banking sector, and (iii) removing the statutory obligation to report all known or suspected breaches to the regulators. The Bill also provides for the regulators to extend the conduct rules under the SMCR to apply to non-executive directors at a later date.

Market participants have expressed concerns that the extension of the SMCR under the Bill could lead to a double implementation burden for insurers, as they will have to implement the Senior Insurance Managers Regime ("SIMR") in early 2016 and then implement the SMCR when it is extended under the Bill, currently expected to be in 2018.

BACKGROUND

Following changes set out in the Banking Reform Act 2013, the FCA and PRA are in the process of reforming and replacing the existing APR with the SMCR and the SIMR.

The SMCR applies to UK banks, building societies, credit unions and PRA-designated investment firms, and branches of foreign banks operating in the UK (together, “Relevant Regulated Entities”). They will enter force on 7 March 2016 along with a new set of conduct rules governing approved individuals in Relevant Regulated Entities.

The SIMR applies to all Solvency II insurers as well as UK branches of non-EEA insurers, the Society of Lloyd’s and managing agents, and Insurance Special Purpose Vehicles. For insurers not falling under Solvency II, the FCA is introducing a streamlined version of the SIMR. The SIMR will be implemented in two stages, with the Solvency II elements coming into force on 1 January 2016 and the remaining elements on 7 March 2016.

The existing APR will continue alongside these new regimes for non-deposit-taking firms.

However, under the Bill the SMCR will be extended to all regulated firms in 2018 and, once in force, will replace the SIMR and the residual APR provisions.

STATUTORY DUTY OF RESPONSIBILITY

The Bill replaces the presumption of responsibility with a statutory duty of responsibility. The same underlying obligation is intended to remain on the individual, ensuring that they take reasonable steps to prevent regulatory breaches in their areas of responsibility.

The burden of proof will now be on the regulators to show that an individual failed to take reasonable steps to prevent a regulatory breach. It is nonetheless advisable for firms to keep thorough and accurate records to provide a paper trail of evidence with which they can show that those reasonable steps were taken should the regulators wish to take action. This is especially pertinent given the allocation of individual responsibilities which Relevant Regulated Entities must undertake under the SMCR.

EXTENSION TO THE WHOLE FINANCIAL SERVICES INDUSTRY

The Bill extends the application of the SMCR from just Relevant Regulated Entities to all authorised persons under the Financial Services and Markets Act 2000: in effect, to all financial services firms. This will include insurers, investment firms, asset managers, brokers and consumer credit firms. The extension is expected to be implemented in 2018.

This could lead to a double implementation burden for insurers, as they will have to implement the SIMR in 2016 in order for the PRA to fulfil its obligations under Solvency II regarding fitness and propriety, and under the Bill they will then have to implement the SMCR in 2018. However, regulators have seen the SIMR as a stepping stone to implementing the SMCR, so it can be hoped that they will be proactive in reducing the additional implementation burdens on insurers under the new regimes.

HOW DOES THE SIMR DIFFER FROM THE SMCR?

The SIMR is similar to the banking sector's SMCR, with the exception of the key differences:

- no statutory duty of responsibility for senior managers;
- no criminal offence of reckless misconduct in management;
- no certification regime requiring certification of employees; and
- the conduct standards apply directly to individuals in insurers requiring pre-approval by the PRA or FCA, rather than to most employees.

The two regimes are otherwise very similar. Consequently, it is to be expected that the additional implementation burden for insurers in 2018 will not be too onerous.

REACTIONS FROM MARKET PARTICIPANTS

The changes to the regulators' original proposals introduced by the Bill have been welcomed, particularly the removal of the presumption of responsibility which some have described as a "victory for the City."

However, some market participants have suggested that the removal of the presumption of responsibility will not make a significant practical difference to the potentially significant effect of the new regimes, as the combination of (i) the allocation of responsibilities to senior managers and (ii) the statutory duty

of responsibility is likely to provide a much stricter regulatory framework for individual accountability than the current framework.

The extension of the SMCR to insurers is less welcome, due to the possible double implementation burden that it entails.

CONCLUSION

The key changes to the regulatory framework for individual accountability introduced by the Bill are: (i) the removal of the controversial presumption of responsibility; and (ii) the extension of the SMCR to all financial services entities.

The possibility of a double implementation burden for insurers, due to the extension of the SMCR, does raise concerns but it is to be hoped that the regulators will do as much as possible to reduce this burden for insurers.

In the long term, it is likely that the standardisation of the regimes across the financial sector will be a positive change, making it easier for large and complex financial services entities to manage their regulatory compliance.

* * *

Please do not hesitate to contact us with any questions.