MARSH

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CLIENT ADVISORY

SENIOR MANAGERS REGIME UPDATE

ASSET MANAGERS AND NON-BANKS SOON TO BE CAUGHT BY THE SENIOR MANAGERS REGIME

EXTENSION OF THE SENIOR MANAGERS AND CERTIFICATION REGIME (SMCR)

On 15 October 2015, the UK Government announced an extension of the SMCR to asset managers and other financial services firms in the UK financial services industry.

BACKGROUND

As we reported in previous advisers, from 7 March 2016, firms in the UK banking sector (including UK branches of foreign banks, building societies, credit unions, and Prudential Regulatory Authority (PRA) approved investment firms) will be subject to the new SMCR. At the same time, insurers and reinsurers will also be subject to a new Senior Insurance Managers Regime.

The extension of the SMCR is expected to come into force during 2018 and will apply to all other non-banking regulated financial services firms, including investment firms, asset managers, and consumer credit firms. The justification given for extending the regime is to ensure that all firms are subject to the same standards.

While the exact details of the expanded regime will be the subject of regulatory consultation, it is expected to reflect the different sizes and types of institutions involved. However, it is broadly expected to comprise a three-tiered approach in-line with the SMCR and in accordance with the following three levels of responsibility:

1. A Senior Managers Regime.

2. A Certification Regime.

3. Rules of Conduct.

1. SENIOR MANAGERS REGIME (SMR)

The SMR is directed at senior individuals responsible for certain areas of the business and will replace the current Approved Persons Regime for banks. Individuals carrying out a senior management function (SMF) will need to be pre-approved by the regulators. Those who are currently performing an approved persons function will be grandfathered into their new SMF.

2. CERTIFICATION REGIME

Employees who perform regulated activities and who can therefore potentially cause "significant harm" to a financial institution or its customers will be subject to a certification regime. This is likely to be the layer of management below SMRs. While these individuals will not be required to receive prior regulatory approval to carry out their roles, senior managers will be required to annually assess the fitness and propriety of certified staff.

3. THE RULES OF CONDUCT

These will apply to all staff within relevant firms, except those carrying out purely ancillary functions and replace the Financial Conduct Authority's "Statements of Principle" and "Code of Practice" for approved persons. Firms will be required to continually assess employees and take related internal disciplinary actions. However, the obligation on firms to report all known or suspected breaches of Rules of Conduct has now been waived.

IMPLICATIONS FOR FIRMS

Firms will need to consider what processes and systems they need to have in place to deal with the new rules. They must ensure the ongoing fitness and propriety of individuals whose roles could pose a significant risk of harm for the firm's customers, and improve corporate governance more generally.

Firms should also review their internal indemnification agreements and insurance arrangements to address ~ the following types of issues:

- Do firms need to review their internal indemnification agreements and expand the category of individuals with whom the firm has such agreements to include senior managers and certified individuals, the subject of SMCR?
- Should the directors and officers (D&O) liability policy be expanded to include all employees subject to the conduct rules as well as SMRs and certified individuals?
- Does the D&O policy cover regulatory enforcement actions and trigger defence costs cover for individuals who are the subject of such proceedings?
- Are policy limits adequate to cover the expanded pool of individuals or is it necessary to ring-fence some of the policy limit solely for SMRs and certified individuals?

OTHER RECENT DEVELOPMENTS

REMOVAL OF BANKERS' "REVERSE BURDEN OF PROOF"

In October 2015, the UK Government also announced plans to scrap the controversial presumption of responsibility and corresponding reverse burden of proof, and replace it with a duty of responsibility. The original proposal was that a senior manager would be deemed to be individually accountable for his or her business area in which a contravention occurred, unless he or she could prove that all reasonable steps had been taken to prevent or mitigate the wrongdoing (the reverse burden of proof). There will now be a statutory duty on senior managers to take reasonable steps to prevent regulatory breaches in their area of responsibility. Where there is a serious failing of a financial institution, regulators may take enforcement action for misconduct against the senior manager or certified individual responsible for the part of the business involved in the failing. The burden of proving misconduct now will be upon the regulators themselves. Those found guilty could face imprisonment or an unlimited fine.

APPLICATION OF RULES OF CONDUCT TO NON-EXECUTIVE DIRECTORS

Non-executive directors carrying out a SMF are captured by the SMCR. However, the regulators now also have the power to make rules of conduct apply to all other non-executive directors who sit on the boards of financial services firms.

SUMMARY

The proposed extension of the SMCR to non-banking financial services firms including investment firms, asset managers and consumer credit firms, will have varying ramifications for these firms taking into account the different structures, sizes, individuals and varied businesses involved. Firms should be reviewing their internal indemnification procedures and insurance arrangements to ensure they respond to the new exposures and that their D&O policy is fit for purpose.

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