

## MARSH INSIGHTS: THE SENIOR MANAGERS REGIME

### An update on the new regulatory framework for financial institutions

Last year, we reported on the amendments made to the Financial Services and Markets Act 2000 (FSMA) by the Financial Services (Banking Reform) Act 2013, to implement new regimes for individual accountability in the banking system, to take effect on 7 March 2016. Following that briefing, with further information available we are now able to give an update on the upcoming new regimes.

#### BANKING

The new regulatory framework is comprised of a three-tiered approach:

- A senior managers regime (SMR).
- A certification regime (CR).
- Conduct rules.

The reforms are aimed at UK-incorporated banks, building societies, credit unions, and Prudential Regulatory Authority (PRA)-designated firms. Asset management and investment management firms are generally out of scope. The rules will be extended to individuals working in UK-based branches of foreign banks (incoming branches).

The Financial Conduct Authority (FCA) and PRA published “near-final” rules in March 2015<sup>1</sup> in order to give firms as much time as possible to prepare for the changes. The final PRA and FCA rules are expected to be published later this year. We have discussed some of the recent regulatory guidance for the SMR below.

#### SENIOR MANAGEMENT FUNCTIONS

The SMR is directed at senior individuals responsible for certain areas of the business. It will replace the current FCA Approved Persons Regime. In March 2015, the regulators published a list of 17 senior management functions that will be subject to the new senior managers regime, and which will require pre-approval from either the PRA or the FCA.

Included are obvious functions such as chief executive officer, chief finance officer, and executive directors, but the list also includes functions such as heads of key business areas, chairs of sub-committees of the board, chief compliance officers, and money laundering reporting officers. There is also a general catch-all for other managers deemed to hold “significant responsibility” functions. The regime will not apply to non-executive directors unless they chair specified sub-committees of the board (such as the remuneration, audit, or risk committees).<sup>2</sup>

The regulators have proposed that any individual currently approved to perform a “significant influence function” under the current Approved Persons Regime, who will be performing a corresponding senior management function under the new regime, will be eligible to be grandfathered into that new role. Firms must notify the regulators of the names and roles of these persons by **8 February 2016**, after which the FCA will publish the names of senior managers in its register.

#### CERTIFICATION REGIME

We reported last year that more junior employees, who perform regulated activities and who can therefore potentially cause “significant harm” to a bank or its customers, will be subject to a certification regime. The potential scope of those required to be certified is extremely broad and will include most customer-facing roles.

The latest version of the rules introduces annual re-certification requirements for more junior staff. Senior managers will be required to assess the fitness and propriety of more junior staff annually.

#### THE CONDUCT RULES

The new conduct rules will apply to all staff within relevant firms except those carrying out purely ancillary functions. The proposed rules are divided into two tiers: those applicable to all relevant employees, and those applicable to senior managers only. Firms will be required to provide relevant training to employees, notify regulators of suspected breaches of the conduct rules, and take related internal disciplinary actions.

<sup>1</sup> FCA CP15/10: Strengthening Accountability in Banking: UK Branches of Foreign Banks (March 2015).

<sup>2</sup> FCA CP 15/5 / PRA CP7/15 Approach to Non-Executive Directors in Banking and Solvency II Firms (February 2015).

## THE REGULATORY TOOLBOX

Last year, we reported on the expanded toolbox regulators have at their disposal to enforce the new laws. These include imposing unlimited fines on senior managers engaged in gross misconduct leading to bank failings, as well as the ability to apply a reverse evidential burden in certain regulatory proceedings.

If a firm contravenes a relevant requirement, the senior manager responsible for the area where the contravention has occurred could be held accountable if they are unable to satisfy the regulators that they have taken "reasonable steps" to prevent the contravention occurring or continuing.

The recent regulatory guidance sets out the circumstances in which the FCA would seek to apply this presumption, and steps that senior managers should take in order to rebut it – such as having regard to their existing statutory, common law, and equitable obligations. Non-executive directors will not be held to the same standard as senior executives (other than those who hold a senior management function).

## INSURANCE

Insurers and reinsurers are also subject to a new, similar regime - the Senior Insurance Managers Regime (SIMR), which will replace the current Approved Persons Regime. Some of the more onerous provisions of the SMR have been omitted in this new regime, such as the reverse evidential

burden and criminal sanctions. The PRA has also advised that there will be no certification regime equivalent to that which applies to the banks.

The SIMR will cover 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 at insurance companies, and who also need to be assessed as being fit and proper by the PRA. The SIMR comes into force on 7 March 2016, with some interim arrangements applying from 1 January 2016 to take account of the Solvency II Directive.<sup>3</sup>

## DIRECTORS AND OFFICERS (D&O) POLICY CONSIDERATIONS

Firms in the scope of the SMR and SIMR regimes should be reviewing their current D&O policy terms and conditions to assess whether they will respond adequately to the risks faced by individuals under the new rules.

Firms should also consider who they wish to extend coverage to as the new regimes could capture individuals who are not currently the subject of cover. If cover is extended to a wider group of individuals, then the adequacy of policy limits and potential ring-fencing of cover for main board directors should also be considered.

A senior manager who is subject to the reverse evidential burden in regulatory proceedings should still be entitled to have defence costs advanced

by the D&O insurer. This would continue until there is a final non-appealable adjudication against them of fraudulent or criminal conduct, after which the costs are likely to be repayable. Some D&O policies also cover the costs of mitigating any reputational damage in the event of a regulatory enforcement action.

## SUMMARY

The new rules for relevant financial institutions are due to come into force on **7 March 2016**. Firms should be putting in place the necessary infrastructure to support the changes required and should be reviewing their D&O insurance arrangements to ensure that policy terms and conditions will respond adequately to the risks faced by management under the senior new laws.

## CONTACT

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<sup>3</sup> PS3/15: Strengthening Individual Accountability in Banking and Insurance – Responses to CP14/14 and CP26/14.

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