Strengthening accountability in banking

New publications intensify implementation requirements

The UK regulatory authorities continue to develop their proposals for “Strengthening accountability in banking: a new regulation framework for individuals” following the joint consultation paper issued in July 2014. With a commencement date of 7 March 2016 now announced, the suite of recent publications is both timely and helpful in clarifying the regulators’ expectations of the new regimes and turns up the heat for implementation.

This report summarises the significant changes including a more detailed overview of all the notable changes across relevant publications. Please click on the links below for further information.

1. Summary of significant changes
2. FCA/PRA near-final rules for UK firms and new consultation for foreign banks
3. FCA/PRA approach to NEDs and transitional arrangements
4. Still to come (road map to commencement)

For further insight and advice on how to prepare for compliance with the regimes, please get in touch with us or one of the key contacts listed at the end of the report.
Section 1
Summary of significant changes

Senior Managers Regime (SMR)
The scope and application of Prescribed Responsibilities have been tightened with a clearer mapping to Senior Management Functions (SMFs). Four new Prescribed Responsibilities have been introduced, including with respect to remuneration, and the Financial Conduct Authority (FCA) key functions are now guidance only. However, an allocated responsibility is now required with respect to all activities of the firm. The regulators also outline their expectations with respect to reasonable steps and clarify the importance of capturing collective responsibilities alongside the scope of individual responsibilities in the responsibilities map. Also reinforced is the focus of the regime on the most senior managers within an entity, such that challenges will be raised if responsibilities are allocated to managers who themselves have a more senior report. Accordingly, extensive use of the significant responsibilities function, SMF18, is not expected. Importantly, the requirement for annual attestation of compliance with the responsibilities map has been removed as a disproportionate requirement, given existing obligations on firms to communicate material changes to regulators (Principles for Businesses 11).

These changes are constructive in the interpretation and application of regime requirements for firms and respond to points of clarification raised during the consultation. However, they are unlikely to alter the overall approach and intensity of effort required for firms to achieve “day one” compliance. In particular, the removal of the specific attestation requirement is unlikely to change the need for firms to have effective assurance over the operation of the business in line with the responsibilities map and reasonable steps principles.

Non-executive directors (NEDs)
The scope of impact of the new regimes for NEDs has been substantially limited. The chairman, senior independent director and chairs of the audit, risk, remuneration and nomination committees only are now SMFs and subject to the criminal liability provision and presumption of responsibility. Other NEDs are referred to as standard NEDs and are not impacted by any of the regimes, though it is proposed that the scope of associated “fit and proper” requirements be extended for closer alignment with the requirements of the regimes. The regulators have established limited statement of responsibility expectations for NEDs, and the scope of the presumption of responsibility has been clarified as limited to the responsibilities of the specific NED as chairs of the committees.

The limitations and clarifications in the application of the regime for NEDs is a proportionate response to strong feedback to the initial proposals. However, the revised proposals do raise a challenge for standard NEDs to ensure they are protected against potential erosion of their ability to exercise independent oversight, and provide constructive challenge in the way that SMF NEDs respond to their role requirements and associated presumption of responsibility as chairs of the senior committees.

UK branches of foreign banks
Helpful clarification has been provided with respect to the implications for incoming branches, distinguishing between those of European Economic Area (EEA) and non-EEA origin. Bespoke SMFs and Prescribed Responsibilities are detailed for each and are much abbreviated by comparison with UK firms. While this includes confirmation that the criminal liability provision does not apply and that NEDs are not impacted for branches, new SMFs are set out for branch senior managers, which could still have a broad impact, including outside of the UK for non-EEA branch activities.

The application of the regime for branches has been much awaited, and generally the direction that has been set is consistent with market expectations. The scope of capture of overseas senior managers remains a matter for further discussion, as does the suggestion that all current significant influence approved persons would grandfather across as either branch senior managers or certified employees. The requirements of the new regime
are clearer than the old, as are the consequences, and many organisations will want to reconsider the basis for prior regulatory approvals and test their future validity.

Certification regime
The certified population needs to be identified and notified to the regulators by 7 March 2016 and their ongoing fitness and propriety monitored from that date. Physical certificates do not need to be issued until 7 March 2017. In addition, the “chain of certification” is clarified such that the supervisor of any certified individual must also be certified unless that supervisor is a senior manager.

While this provides clarification on the scope of application and allows for a full year for firms to finalise physical certification, in real terms it makes little difference to current planning requirements and a one-year delay was not unexpected. However, firms are likely to issue certificates as part of the annual performance review process and as such currently intend to deliver these at the end of 2016 rather than wait until the regulators’ deadline.

Implications for current planning
Overall, the suite of recent publications has been more comprehensive and directive than might have been anticipated, and has provided organisations with a much more informed basis on which to plan. What is clear is that, while proportionality has been exercised with respect to particular issues, the regulatory intent and expectations for compliance are unmoved, and firms have much to do to be ready for the commencement date.

While most firms have now set up a response programme and have largely completed their initial analysis of regime requirements, there is little time to take stock, as the detailed delivery work must progress quickly if “day one” compliance is to be achieved.

EY has been supporting a number of leading firms in designing and developing their response to the regimes and offering unparalleled insights into the different approaches being taken across the market. We have also developed proven accelerators in the assessment of central regime requirements and the design of appropriate responses.
Section 2
FCA/PRA near-final rules for UK firms and new consultation for foreign banks

Detailed overview of notable changes across relevant publications – 16 March and 23 March 2015

1. PRA feedback and near-final rules for UK firms – Strengthening individual accountability in banking and insurance – PRA responses to CP14/14 and CP26/14 (PS3/15)

2. FCA feedback, new guidance and near-final rules for UK firms – FCA feedback on the new accountability regime for banks and other relevant firms, covering key aspects of the SMR (FCA Feedback on FCA CP14/13 and PRA CP14/14)

3. Accountability regime for UK branches of foreign banks – (Joint consultation FCA CP15/10/PRA CP9/15)

1 and 2. PRA and FCA feedback, new guidance and near-final rules for UK firms

Attestation
The requirement for a written annual certification of compliance with the management responsibilities map, including firms’ obligations under the SMR and the certification regime, has been removed. Instead, the regulators will rely on the existing cooperation and disclosure obligations owed to them as a basis for firms to notify them of instances of noncompliance on a timely basis. This is a positive change from the original consultation and will challenge firms to determine for themselves the extent of assurance they consider appropriate to confirm that such significant and high-profile regulatory requirements remain compliant on an ongoing basis.

Presumption of responsibility
The proposed FCA guidance on reasonable steps defence recognises the role of collective decision-making, as well as statutory, common law and equitable obligations. This will be considered when determining whether a senior manager has acted appropriately. This is a welcome clarification, recognising the importance of the role of the Board and associated committees in decision-making.

New SMF Prescribed Responsibilities
Four new Prescribed Responsibilities are introduced in relation to stress testing, financial crime, compliance with CASS and the development and oversight of remuneration policies and practices, which must be allocated to a senior manager. Additionally, definitions of responsibilities and senior manager roles have been tightened, providing greater clarity as to how responsibilities should be allocated between executives and non-executives, which better reflects the different management and oversight roles inherent within each. There is a clear expectation set by PRA that prudential responsibilities will not be split between senior managers, although there is potential for more than one senior manager to jointly share PRA-prescribed responsibilities. The flexibility for organisations to either split or share FCA responsibilities remains with a clear expectation that all of a firm’s business activities will be covered by one or more senior managers, regardless of whether the business activity has been specifically identified by the regulator as a key function.

Culture responsibility of chairman and CEO
The two responsibilities relating to leading the development of culture and standards, and its implementation across an organisation, have been refined to clarify the respective non-executive and executive roles of the chairman and CEO, while recognising that culture and standards are a collective matter for the Board.

Group entity senior manager
The identification requires a direct link between an individual’s decisions, powers and responsibilities, and the areas and activities of the firm, subject to UK regulation to be within the scope of a senior manager’s role or responsibilities. The PRA expects the population captured to be broadly consistent with group personnel already approved under the approved person regime either as directors, NEDs or as holders of SMFs.
**Fit and proper certification**

While the certified population needs to be identified and notified to the regulators by 7 March 2016, and its ongoing fitness and propriety monitored from that date, physical certificates do not need to be issued until 7 March 2017. While this provides for a full year for firms to finalise certification, in real terms it makes little difference to the current planning requirements, and the deadline of a year post commencement is not unexpected. Firms are currently required to ensure that the approved staff are fit and proper for the roles they perform, this is also the case for those grandfathered into the certification regime and those who will become regulated for the first time as a consequence of the certification regime at the commencement date. It should also be ensured that they remain so on an ongoing basis thereafter. This requires firms to establish the standards and process for certification prior to the commencement date. Many firms are likely to issue certificates as part of the annual performance review process. And, as such, may deliver these at the end of 2016 rather than wait until the regulators’ deadline.

**Chain of certification**

Clarification of the intention that every manager above a certified employee is expected to be certified until a relevant senior manager is confirmed and increases the volume of individuals to be captured both within the UK and overseas. This will require careful consideration of the substance of matrix reporting lines.

**Conduct rules**

The scope and requirements remain unchanged, although the FCA will consider the frequency and method of reporting requirements in finalising the rules. PRA feedback and policy statement on conduct rules and regulatory referencing remains outstanding.

**Proportionality for small firms**

For smaller firms with total gross assets of less than £250m; a tailored regime is introduced with fewer PRA Prescribed Responsibilities and SMF roles required.

**Whistle-blowing**

Firms will be required to allocate the prescribed responsibility for the independence, autonomy and effectiveness of a firm’s policies and procedures on whistle-blowing to a NED senior manager.

**3. Accountability regime for UK branches of foreign banks**

**No criminal liability for branches:** The consultation paper confirms that the criminal liability for reckless misconduct does not apply to either EEA or non-EEA branches.

**NEDs:** Neither PRA nor FCA intends to bring any NED functions into the scope of SMR for incoming branches of either EEA or non-EEA branches.

**New SMFs for UK branches of foreign banks:**

The consultation paper for incoming branches distinguishes between non-EEA and EEA branches and establishes a bespoke set of relevant SMFs.

► **For non-EEA branches, the PRA** proposes pre-approval of at least one individual as a Head of Overseas Branch (SMF19), this being the individual(s) with the highest level of decision-making authority within the branch over activities subject to UK regulation; other individuals based in a non-branch group entity with direct management and/or decision-making responsibility over the UK-regulated activities of a UK branch are proposed to be pre-approved as Group Entity Senior Managers (SMF7); individuals dedicated to performing executive SMFs (Chief Finance, Chief Risk and Head of Internal Audit functions) are to be pre-approved; and the PRA has proposed a customised set of Prescribed Responsibilities.

► **For non-EEA branches, the FCA** proposes that individuals with local responsibility for a business area, activity or management function, and who typically report to the Head of Overseas Branch, are captured as an Overseas Branch Senior Manager, OBSM, (SMF20); appointments for the functions of Money Laundering Reporting Officer (MLRO) (SMF17) and Compliance Oversight (SMF16) will also be required; the FCA proposes a specified subset of the PRA’s customised responsibilities for non-EEA branches and two FCA-only responsibilities in relation to CASS and financial crime. SMF20 replaces SMF18 for non-EEA branches. Overall, there are 13 prescribed responsibilities that will require allocation across the identified senior managers.
For EEA branches, the PRA proposals will not apply and, in contrast to non-EEA branches, territorial limitations mean all three regimes will be restricted to individuals based in the UK.

For EEA branches, the FCA proposes an MLRO function (SMF17) and a tailored **EEA Branch Senior Manager, EBSM, (SMF21)** to capture the individual(s) responsible for the management and conduct of the business of the incoming branch; the latter is intended to reflect the current coverage of significant management function under the approved person regime, namely existing SMFs (controlled function 29 holders). The FCA will not determine the fitness and propriety for an individual performing EBSM, and there is no allocation of responsibilities to senior managers within EEA firms.

### Certification regime for UK branches of foreign banks to align with UK firms

The consultation paper for incoming branches sets out that the PRA will base its definition of a “certification function” on the definition of a Material Risk-Taker for non-EEA branches only, while the FCA proposes to align the scope of its certification regime for both non-EEA and EEA branches with that for UK-relevant firms where applicable and respecting EU law.

### Remote booking

The consultation paper confirms expectations that the senior manager of the UK branch will be responsible for remote booking into the UK branch.

### Proportionality

The consultation paper recognises that there is a range of complexity across incoming branch operations and differentiates the regulatory expectations between non-complex branches and more complex structures both in terms of the management responsibility map detail required and the number of expected senior managers and certified employees.

### Attestation

There is a requirement for an annual attestation by a non-EEA branch of compliance with obligations under SYSC, and this requirement has been brought into the SMR as a Prescribed Responsibility.

Firms have until the 16 June 2015 to comment on FCA consultation on the presumption of responsibility guidance and until the 25 May 2015 to comment on the foreign branches consultation.
Section 3
FCA/PRA approach to NEDs and transitional arrangements

Notable changes to relevant publications:
16 February 2015 and 19 December 2014
► Approach to NEDs in banking and Solvency II firms and application of the presumption of responsibility to senior managers in banking firms (FCA CP15/5/PRA CP7/15)
► Strengthening accountability in banking: forms, consequential and transitional aspects (FCA CP14/31/PRA CP28/14)

1. Approach to NEDs

Reduction in the number of non-executive senior managers
The consultation paper reduces the number of required NED senior managers to only the chairman, the senior independent NED and the chairs of the risk, audit and nomination committees where relevant. Importantly, the chair of the nominations committee is an FCA-required role only and establishes an authority for them with respect to the chairman of the committee that approves senior executive and non-executive appointments.

Group entity senior manager
Non-independent or shareholder representative NEDs are most likely to be deemed group entity senior managers and will be subject to criminal liability under the presumption of responsibility.

NEDs of UK branches of foreign banks
Are not in the scope of the regime.

Presumption of responsibility and criminal liability for non-executive senior managers
Non-executive senior managers are subject to the presumption of responsibility in respect of their statements of responsibility; these are expected to be less extensive than those for executives and limited to the relevant non-executive responsibilities.

Standard NEDs
NEDs not identified as SMFs are described as standard NEDs, for whom no regulatory pre-approval is required. Instead, notification to the PRA is sufficiently consistent with the direction of Capital Requirements Regulation (CRR) and Markets in Financial Instruments Directive (MiFID). However, although not within the certification regime either, standard NEDs will be required to demonstrate fitness and propriety in line with The Fit and Proper Test for Approved Persons Handbook (FIT) on an ongoing basis. This will include the requirement for criminal checks going forward. While on one level, this will be seen as a proportionate step in clarifying and limiting the extent of impact of the regime for NEDs, it also creates challenges to ensure that standard NEDs are protected against potential erosion of their ability to exercise independent oversight and provide constructive challenge to the way that SMF NEDs respond to their roles and the presumption of responsibility as chairs of the senior committees.

Criminal liability
Standard NEDs are not within the scope of the SMR and therefore not criminally liable under the Banking Reform Act in the event of the failure of a firm, although the regulators retain the ability to prohibit NEDs not within the scope of the regime.

All NEDs to be included within responsibilities maps
This provision reflects the role of collective decision-making, although no statement of responsibility is required for standard NEDs.

Certification regime and conduct rules
NED senior managers are subject to the requirements of the certification regime and conduct rules, and are expected to exercise the standard of care, skill and diligence that would be expected by a NED. For standard NEDs, the FCA has determined that NEDs are, normally, not employees and, as such, are exempt from the certification regime and the conduct rules. However, the PRA proposes to incorporate conduct rules one, two and three and SM conduct rule four as part of the scope of FIT requirements for standard NEDs going forward. This, combined with the prescribed responsibility to confirm the application of FIT for the Board, results in the effective application of those specific conduct rules for standard NEDs.

Firms have until the 27 April 2015 to comment on Consultation CP 15/5.
2. Strengthening accountability in banking: forms, consequential and transitional aspects

Commencement date
From 7 March 2016 (the commencement date), the following aspects of the new regimes will apply:

► The SMR and enhanced enforcement regime will begin.
► The conduct rules will apply to senior managers and certified individuals.
► Approvals for all current approved persons who are not transitioned as senior managers lapse.

Notification date
By 8 February 2016, firms will need to notify the regulators of the existing senior managers being grandfathered into the new regime and provide the regulators with the management responsibilities map and senior manager statements of responsibility. In addition, all applications for the appointment of any new senior managers should be submitted.

Grandfathering
Firms will not be required to obtain regulatory references or criminal records checks for individuals subject to grandfathering unless the individuals subsequently apply to perform a different SMF.

Breach notification
The consultation proposes the extension of the requirement to notify the PRA within seven days of breaches of conduct rules to include PRA-certified individuals as well as senior managers.

Approved person regime
The regulator proposes to change the status of the existing APER principles to rules and clarify application to all controlled functions outside those individuals and legal entities captured under the SMR.

This consultation is now closed.
Section 4
Still to come (road map to commencement)

1. FCA and PRA final rules on accountability (including feedback on the FCA and PRA consultation on forms, consequential and transitional aspects, FCA CP14/31/PRA CP28/14) - spring/summer 2015

2. If necessary, FCA consultation on expansion of the certification regime in regard to wholesale markets - summer 2015 (followed by a policy statement by end 2015)

3. FCA policy statement on UK branches of foreign banks (subject to Parliament extending the regime to foreign branches)
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