FCA CP17/25: Extending the senior managers & certification regime to all FCA firms

Response by the Building Societies Association

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Building Societies Association

Introduction and executive summary

1. The BSA is pleased to respond to FCA CP17/25 (the CP). Our key comments are as follows; the BSA –

- supports the extension of a senior managers and certification regime to the other regulated financial services sectors; and emphasises the importance of fairness, consistency and proportionality across all regulated sectors

- raises some technical and practical concerns about certain subsidiaries of deposit-takers

- asks the FCA to be clear about any changes arising from the CP that also affect sectors outside of FCA solo-regulated firms (eg deposit-takers), so that there is no confusion between sectors about which rules do, and do not, apply, and

- calls on the regulators speedily to draw a line under any further changes to the SM&CR for deposit-takers, so that firms can get on with business as usual and regulators can properly assess the success or otherwise of the overall regime's implementation.

Extension of the senior managers and certification regime to all FCA firms

2. The BSA supports the extension of a senior managers and certification regime across all regulated financial services firms. While serious misconduct in the banking sector was the focal point of the *strengthening accountability in banking* exercise, no sector has a monopoly on either poor or good conduct, and it is therefore right for the FCA to apply broadly consistent principles, in a proportionate way (reflecting the size, scope and activities of a firm), across the whole of its regulated communities.

3. We accept the logic of the FCA's statement in paragraph 1.10 –

> *"There will be many different types of firms that will be in scope of the SM&CR, so we do not think it is appropriate to take exactly the same approach as we did for banks. While we want to have consistent principles applied across financial services, we also want the new regime to be proportionate and flexible enough to accommodate the different business models and governance structures of firms."*

However, it is important to bear in mind that there are also very wide differences in scale and nature of business among the deposit-takers already subject to the FCA and PRA SM&CR regime – for example, a major international bank compared to a small credit union. We acknowledge that the regulators took reasonable steps to accommodate those differences, for example with arrangements whereby smaller deposit-takers and credit unions could have fewer senior management functions, prescribed responsibilities etc.

4. We are not clear why the FCA does not simply carry across to the firms in scope of the CP the proportionality elements already built into the regime for deposit-takers – an approach that could help ensure clarity and consistency across the board. For example, small building societies and credit unions should not be subject to disproportionate requirements compared with FCA solo-regulated firms that are of broadly equivalent size etc.

5. Nevertheless, we acknowledge that we are not familiar in detail with the business arrangements of the firms that are within the main scope of the CP and, therefore, do not comment on the detailed proposals. The BSA mainly reiterates the importance of consistency, proportionality and fairness, and trusts that the FCA will ensure that broadly comparable firms in different sectors will not be subject to fundamentally different and more onerous levels of requirement.

6. However, we highlight one particularly important point. Paragraph 2.9 of the CP states the following –

> *"This Consultation Paper does not affect individuals and Approved Persons of*

Appointed Representatives of firms. We will confirm how we intend to approach the SM&CR for Appointed Representatives in a follow-up Consultation Paper. Principal firms, including the Senior Managers of principal firms, remain fully responsible for ensuring that their Appointed Representatives and networks comply with our rules."

We believe it imperative, in the interests of consumer protection and of fairness across firms, that the regimes for appointed representatives are consistent across all sectors. For example, a mortgage adviser with a non-deposit-taking lender should be subject to the same requirements as one with a bank or a building society. Generally speaking, consumers should not be expected to know the differences and they are entitled to benefit from consistent levels of regulatory protection, irrespective of the nature of their loan provider or adviser. If legal or rule changes are required to ensure this consistency, then it is crucial to take the necessary steps without undue delay.

Deposit-takers and their subsidiaries

7. The CP does not deal specifically with subsidiaries of PRA/FCA dual-regulated firms, such as deposit-takers, and especially those that do not hold their own resources (eg staff, systems etc), but operate an intra-group outsourcing arrangement with the parent entity eg a building society. Some of our members have this kind of arrangement and the rules would class some of the subsidiaries as 'core regime' firms under the proposals in the CP.

8. We understand that frequently the approved persons within a subsidiary will be society employees. For example, a relevant individual might be an executive director, a chief risk officer or a MLRO. However, they would not necessarily include a chief executive or a chairman. Table 1 on page 20 of the CP lists the SMRs in the core regime and includes both these functions (SMF1 and SMF9).

9. It is important that the new requirements accommodate such arrangements. Of course, there must be clear and explicit accountability in respect of the subsidiary, but it would be very difficult if perfectly acceptable business arrangements had to change purely to fit a regulatory formulation.

10. We make similar observations regarding prescribed responsibilities, which could lead to certain senior managers having multiple statements of responsibility (SoRs). It would be very helpful if their responsibilities in respect of a subsidiary could be amalgamated into their existing SoRs.

11. Looking at the prescribed responsibilities for core firms in a little more detail, certain points arise as follows –

- **PR2** (performance by the firm of its obligations under the Certification Regime) – we understand that certain subsidiaries do not include certificated staff, so the PR is redundant in such cases.

- **PR6** (responsibility for ensuring the governing body is informed of its legal and regulatory obligations) – in many subsidiaries, this PR will be redundant because they will rely on the legal function in the holding body. In addition, PR6 appears to have no equivalent under the existing scheme for deposit-takers. We still await feedback following the FCA's discussion paper on the legal function published in September 2016 (DP16/4). It would be helpful to know when we will see progress on DP16/4, which is now over a year old, and how the FCA would achieve consistency across sectors on this matter.

12. On a broader point concerning subsidiaries, would the FCA treat non-FCA regulated subsidiaries of regulated firms differently from FCA regulated ones? Moreover, how would the FCA deal with subsidiaries that had part FCA regulated and part non-FCA regulated businesses?

13. Similarly, we will need to look carefully at responsibilities for conduct going forward. COCON 1.1.7R indicates that, whether an activity is FCA regulated or not, the conduct rules will apply to the individual in question's conduct. How will the FCA accommodate this rule going forward across all sectors?

Changes that affect deposit-takers

14. The BSA supports the proposed relaxation of the 12-week rule, dealt with in paragraph 10.2-3 of the CP. In practice, the rule can be difficult to operate effectively and some, albeit limited, relaxation is welcome. The reality is that, taking into account the time it might take to resolve the outgoing individual's situation, together with the length of the appointment process (and sometimes long notice periods, especially for very senior staff etc), 12-weeks can be unrealistically challenging in a number of cases.

15. The CP includes some helpful signposting on changes to rules and guidance, in particular paragraphs 11.7-8 in the main body of the CP, and Annex A. However, while Annex A specifies provisions that the FCA proposes to move or delete, it does not highlight what are any *substantive* proposed changes for deposit-takers. Chapter 10 in the CP itself covers a small number but it does not appear to be comprehensive.

16. The further we examined the CP, the more potentially substantive changes (sometimes of an indirect nature) we identified in relation to deposit-takers; for example, changes to SYSC 4 Annex 1G (which the FCA plans to move to SYSC 25) with the removal of IT and the addition of other functions. Readers need to go to page 138 of the CP (in the Annex) to see these proposed changes, because their applicability to deposit-takers does not appear to be signposted in the main body of the CP.

17. There appear to be other examples (unflagged in the body of the CP), for instance comprising the following additions to SYSC –

"SYSC 26.2.2G - The purpose of this chapter is not primarily to ensure that formal responsibility for everything a firm does is allocated amongst its senior management. Even without the requirements of this chapter, responsibilities that have not been allocated explicitly would fall to the chief executive by default. However, one of the purposes of this chapter is to avoid responsibilities being allocated by implication or by default . . . .

26.2.3G (2) - If a firm allocates responsibilities under this chapter to an SMF manager other than the chief executive, the chief executive will be responsible for managing that person's performance of those responsibilities in the same way that the chief executive manages that person's other responsibilities."

What appears to be the broadly corresponding current SYSC provision (SYSC 4.7.9G) would be deleted. Even if the new provisions were purely clarificatory, we would have thought that (in view of the subject matter concerning chief executives' responsibilities) the FCA would have included a reference to them in the main body of the CP.

18. This all leads us to two conclusions –

(i) we believe that the FCA should set out, in a separate list, all of the substantive changes (including points of clarification that are nevertheless of a potentially substantive nature) proposed in the CP that would impact on deposit-takers, and

(ii) ensure clear signposting in the Handbook for each sector, as appropriate, because it is in no one's interest for deposit-takers or other sectors to be confused about which Handbook provisions do, and do not, apply to them.

19. On a much broader point, it is now well over two years since the regulators published 'final' rules, following a series of consultations on earlier draft rules. Further amendments followed the final rules, under the Bank of England and Financial Services Act 2016. Still further modifications followed, or are currently in train, in relation to senior management functions and prescribed responsibilities.

20. Therefore, with all of this detailed consideration and implementation having taken place over an extended time-period, we are surprised that the FCA should, at this late point - and in a CP primarily aimed at a separate community of FCA solo-regulated firms - canvass still more modifications to the prescribed responsibilities of deposit-takers (in chapter 10 of the CP). This continuing process of proposing further modifications, adjustments and optimisations to existing SMFs, prescribed responsibilities etc is a problem for three important reasons –

- first, after such a lengthy and detailed process, firms should be entitled to be able to get on with SM&CR on a 'business as usual' basis, without constantly having to review and change their arrangements because of further regulatory modifications. They need to be allowed to get on with their obligations to run

their businesses in a prudential and customer outcomes-focused fashion, rather than have management time constantly diverted to regulators' adjustments and modifications (all of which precede formal regulatory reviews of SM&CR)

- second, while the regime is in a continuous 'work in progress' state, it is difficult to see how the PRA and the FCA can launch serious thematic reviews examining whether the SM&CR has worked well or not, and whether or not modifications predicated on actual experience are required.

  We think that, once the regime is finally embedded in full, a reasonable period of time (certainly at least a year or two) would have to pass before any valid broad thematic exercise could realistically take place. (However, we do appreciate that certain discrete elements, where the rules and guidance have already settled, might be open to review of implementation – for instance, we understand that the PRA is currently reviewing certification)

- third, there is a risk that modifications that are ever more granular will prove counter-productive to a key objective of the *strengthening accountability in banking* exercise, ie to provide clarity in relation to personal accountability.

  So while, in principle, there is nothing wrong with assigning responsibility for conduct rules training and reporting, how would this align (in practical accountability terms) with certain, pre-existing responsibilities including the firm's performance of its obligations under the SMR (which presumably includes the conduct rules); and the broader prescribed responsibility regarding induction, training and development of senior management?

21. Only time will tell whether all concerned (not only businesses, but also governments and regulators) have learned the copious lessons of the last decade or so, stemming from the financial crash, LIBOR, PPI, foreign exchange etc. The SM&CR is potentially a very important component in ensuring that all parties have indeed learned their lessons and that this carries through in practice. For deposit-takers, all the fundamental elements are now in place. Further adjustments and modifications to their regime in the short-term would simply cloud the waters.

22. Therefore, the BSA calls on the regulators to draw a line under any further changes to the SM&CR for deposit-takers from early 2018 (including a prompt decision by the FCA on the legal function – see DP16/4 above). This would then give deposit-takers a reasonable opportunity to embed the full and final regime before the regulators review it as a whole.

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