

Strengthening accountability in banking

BSA response to PRA CP 34/16:
Amendments and optimisations

3 January 2017

 **Building Societies
Association**

Introduction

This response provides comments on PRA CP 34/16 (the CP), which deals with –

- the PRA’s expectations on the duty of responsibility,
- the application of the conduct rules to notified/standard NEDs, and
- a range of proposed technical amendments.

The BSA supports the PRA’s proposals regarding the duty of responsibility and the application of the conduct rules to notified/standard NEDs, which are consistent with earlier representations made by the BSA.

What we would like to see from the regulators going forward is a consistent approach to the application and interpretation ‘reasonable steps’ across relevant areas of conduct.

We also broadly support the various optimisations and amendments proposed elsewhere in the CP, with one or two suggested adjustments – especially see paragraph 13 below.

Once the new provisions come into effect next year, it would be helpful if firms could move onto a ‘business as usual’ basis regarding this very worthwhile, but very lengthy, detailed and time consuming exercise.

Duty of responsibility

QUESTION 1: *Do you agree with the proposed PRA expectations on the new duty of responsibility as set out in the revisions to Supervisory Statement 28/15 in Appendix 3 to this CP? If so, do you have any comments or suggestions on the draft text?*

1. As the CP notes, at paragraph 2.9, the PRA's expectations and the FCA's guidance (consulted on in FCA CP16/26) have been developed in close co-ordination and are aligned in substance. We welcome this regulatory co-ordination. The BSA has also responded to FCA CP16/26 and the comments we set out below are similar to our response that that CP in relation to the guidance proposed for DEPP in the FCA Handbook. The PRA proposed guidance is in Appendix 3 to the CP – draft paragraphs 2.59 -2.78 of draft revised Supervisory Statement 28/15.
2. While the two sets of regulatory proposed guidance are not identical, they do appear to be reasonably well aligned. It would have been ideal if the regulators could have produced a joint table of guidance making it easier for all concerned, but especially dual-regulated firms, to identify the matters in common and the differences. In lieu of a joint paper from the regulators, the BSA has carried out this exercise and provided it to our members to assist clarity.
3. However, when read together the respective sets of guidance provide a fairly clear picture of the kind of conduct likely to help constitute and substantiate reasonable steps. They are, in all key respects, consistent with the guidance that the BSA has already provided to its members. Some of the cross-references (eg in paragraph 2.65) to conduct rules and other areas are also helpful in drawing a wider picture. We also appreciate the PRA's explicit recognition of the role of NEDs, when compared to executives, in paragraph 2.66.
4. What we would like to see from the regulators going forward is a consistent approach to the application and interpretation 'reasonable steps'. We recognise that achieving such an approach was difficult in the past because of the challenges for a regulator in ascertaining which individuals were responsible for a firm's misconduct. But all firms now have SMFs, prescribed responsibilities, individual statements of responsibility, and management responsibilities maps. Therefore, in future the key will be fair, proportionate and consistent enforcement against all firms and all individuals as appropriate, irrespective of size of firm or seniority of the individual.

Conduct rules and notified NEDs

QUESTION 2: *Do you agree with the PRA's proposals for applying the Conduct Rules and/or Conduct Standards to Notified NEDs in RAPs and insurers? In particular, do you agree with:*

- *the specific Conduct Rules and Conduct Standards that the PRA proposes to apply to Notified NEDs; and*
- *the proposed deadline for notifying the PRA of internal disciplinary action for breaches of the Conduct Rules against Notified NEDs in RAPs under section 64C of FSMA?*

5. The proposals from the PRA and the FCA (CP 16/27) are completely aligned in respect of the application of the conduct rules to 'notified' (also sometimes referred to as 'standard') NEDs, and the BSA fully supports the proposal as it now stands. The BSA's long-term position has been that, in a unitary board, **all** directors should be subject to the conduct rules. For example, in April 2015 in our response to PRA CP7/15 (FCA CP15/5), we stated –

“But there is a clear risk the dual status of NEDs could introduce behavioural differences at board level: some NEDs could feel a higher level of personal responsibility and risk than others. There is a possibility that this divide in behaviours could potentially undermine the collective decision-making responsibility of the

board. In addition, it may become increasingly difficult, or disproportionately expensive, to attract NEDs to “non-standard” roles.

One way to address this concern, if only partially, is to require all - that is “standard” and “non-standard” - NEDs to observe the conduct rules. This would ensure board decisions were based on the same underpinning principles and culture.”

6. In view of the fact that the individual conduct rules will apply to most ‘junior’ staff from 7 March 2017, the inclusion of notified/standard NEDs within scope of the rules would help engender a culture within firms that “we are all in it together” regarding prudential management, good conduct and TCF. In our response to the consultations referred to above, among other things, we made the following point –

“Under current proposals, junior staff would be fully, and individually, captured by the conduct rules, while a large cohort of directors [standard NEDs] would not be. How can it be sensible to bring junior staff into the net, while excluding certain directors? Junior staff did not sit on the boards of the firms that failed prudentially and/or in conduct terms – directors did.”

We are pleased that the PRA reflects this point in paragraph 2.11 of the CP.

7. The underlying obligations in senior conduct rules 1-3 are consistent with executive responsibilities and, in a different - oversight - way, with some of the specifically delineated responsibilities of the chairman, chairs of relevant committees and the senior independent director. However, they are not really consistent with the roles and duties of a notified/standard NED.

8. Senior conduct rule 4 (openness with regulators) is fundamentally different in nature and we believe that its application is entirely consistent with the oversight role of a NED, including a notified/standard NED. Therefore, we support the PRA’s proposal to apply the rule to notified/standard NEDs.

9. Regarding breach reporting, we agree with the PRA’s proposal that the same, seven business day, notification deadline should apply to notified/standard NEDs as the PRA requires in respect of approved NEDs and certification staff. The rationale set out in paragraph 2.17 of the CP is fair and logical.

Other matters

10. While the key proposals in the CP are those considered above, there are some other quite significant proposed changes. We fully understand why, in the relatively early stages of a very extensive exercise, there will inevitably need to be a period of amendment and adjustment. However, the resource that firms (including many quite small businesses) have had to apply over a long period of time to a project of this nature - and continue to apply - is considerable.

11. Therefore, it would be very helpful if, once any teething problems or issues in the SM&CR rules have been remedied or clarified, the regulators would allow a prolonged period for the new regime to bed down, before proposing yet more substantive changes. A ‘business as usual’ approach from the time that the all new provisions come into effect during 2017 would be very welcome. Indeed, a degree of consistency, generally absent in relevant law, regulation and regulatory structures for nearly two decades, would greatly help consumers and the economy, as well as firms, especially with significant changes resulting from the UK’s departure from the European Union on the horizon.

- **Conditions, time limits and variations of approval**

QUESTION 3: *Do you agree with the proposed modification to the PRA's Statement of Policy on conditions, time limits and variations of approval?*

12. This appears to be a logical proposed amendment and we support it.

- **Proposed new PRA SMF: Chief Operations**

QUESTION 4: *Do you agree with the proposal to create a Chief Operations PRA SMF and the proposed definition and scope of the function?*

13. We support the PRA's proposal to introduce a new SMF (Chief Operations – SMF23) responsible for “managing and ensuring the operational continuity of the internal operations, systems and technology of a firm” (paragraph 3.2 of the CP), and therefore covering matters such as critical infrastructure and technology resilience, cyber risk, and operational continuity in resolution. However, there is an issue concerning wording. In any context, the control of risk can never be absolute. Just as a regulator cannot ‘ensure’ regulatory compliance by firms, a head of operations cannot ‘ensure’ operational continuity in all respects – there are simply too many variables outside of his or her control. Therefore, we suggest that the words “taking reasonable steps towards” be included before the words “managing and ensuring ...”. All other similar requirements should be consistent in this respect.

14. Firms will be required to assign this SMF only if they have an individual performing the function (paragraph 3.5) and, as paragraph 3.7 of the CP notes, most individuals likely to be covered by the proposed new SMF in large firms are probably already in the scope of the SMR. It would be possible to base an argument against the proposal on these factors. However, we know that the industry and both regulators recognise the crucial importance of operational resilience, and that there should be appropriate senior management accountability for it. Creating a specific SMF for this vital area makes sense.

15. There is one outstanding point that would need clarification; namely, would the new SMF23 effectively replace FCA Business Activity 23 (Business continuity) or do the PRA and the FCA expect a firm to show management responsibility for both? How would the regulators expect this to be handled going forward?

QUESTION 5: *Do you agree with the new Prescribed Responsibility for ‘managing the areas, processes and systems aimed at preserving the operational resilience (including technology security), and the operational continuity of a firm’s functions?’*

16. As explained in paragraph 3.8 of the CP, this proposed new prescribed responsibility complements the proposed new SMF23 (above). Therefore, it seems to be a sensible addition to the list of prescribed responsibilities.

17. We note (paragraph 3.9) that, although a firm will not necessarily have to assign an individual to SMF23, it will be necessary for most firms (although not credit unions or other firms with gross assets of £250 million or less) to allocate the new prescribed responsibility to a suitable executive SMF.

Head of Key Business Area

QUESTION 5 [sic]: *Do you agree with the proposed revised definition of Head of Key Business Area function (SMF6)?*

18. We took the view that the original criteria for SMF6 were likely to capture only a small number of individuals within BSA member organisations. We do not think that the proposed extension of the criteria will cast

the net wider for of our members. Therefore, in view of the fact that the PRA's logic seems sound, we have no reason to object to, or question, this proposal.

- **Statements of responsibilities and management responsibilities maps**

QUESTION 6: *Do you have any comments, questions or suggestions relating to the PRA's expectations on SoRs and MRMs in the draft revised SS28/15 in Appendix 3? Implementation dates*

19. As noted above, we recognise that in an exercise as extensive as *strengthening accountability in banking*, there will inevitable be a number of optimisations and amendments in the early stages. And we can see how this will be particularly true in relation to novel concepts like individual statements of responsibility and management responsibilities maps. We appreciate the summary of the PRA's thoughts in paragraph 3.18 of the CP and have examined the relevant draft changes to SS28/15 (draft paragraphs 2.46 – 2.58B).

20. The draft guidance illustrating how individual statements of responsibility and management responsibilities maps can be utilised in relation to different aspects of a firm's corporate governance arrangements is helpful (draft paragraphs 2.46A-G of SS28/15). We agree that these mechanisms should be seen as integral to corporate governance arrangements going forward. The additional practical guidance on the scope of individual statements of responsibility is also potentially useful (draft paragraphs 2.47-2.51 of SS28/15).

21. The clarifications about the 300-word limit, the need to capture senior management responsibilities in the Statement itself (rather than in supporting documents), and the importance of consistency across Statements are also useful (draft paragraphs 2.49-2.53 of SS28/15).

22. Similarly, the clarifications about management responsibilities maps are constructive and helpful (draft paragraphs 2.57-2.58B of SS28/15). However, we note the proposal that a key provision should be deleted; ie that a management responsibilities map *"must be a comprehensive and up-to-date single document that describes the firm's management and governance arrangements"*. In view of the fact that there is no official template for management responsibilities maps, this proposal will give rise to some head scratching. However, the clarifications set out in draft paragraphs 2.58A and B are helpful in our view.

22. In short, a management responsibilities map must still include sufficient and clear information about how the management and governance arrangements in a firm work, but firms will have greater flexibility in determining the most effective method of communicating the information. We believe that, for most firms, management responsibilities maps are likely to continue to be presented on an 'organisation chart' basis, but – in view of the proposed amendment, it would be crucial that the regulators continued to be alert to unnecessarily complicated presentations of responsibilities that could muddy the waters, whether inadvertently or intentionally.

- **Proposed implementation dates**

QUESTION 7: *Do you agree with the proposed implementation dates for the proposals in this CP?*

23. In summary, the proposals in paragraphs 5.1-5.3 of the CP are for most of the new provisions to come into effect within two months of publication of the final rules in Q2/Q3 of 2017. Therefore, it would seem to follow that implementation would be either in Q3 or Q4 of 2017. We note that, for the reasons set out in paragraph 5.3, there might be a later implementation date for the new or changes SMFs and prescribed responsibilities, but broadly speaking the end of 2017 would appear to be pretty much the 'cut-off' point for the whole exercise.

24. The timetable seems sensible and, as noted above, we feel confident that all concerned would (as far as is reasonably practicable) appreciate a 'business as usual' approach once those changes are implemented, in order to allow everything to bed-in, become familiar and have a real opportunity to be tested in practice.

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Our members have total assets of over £330 billion, and account for approximately 20% of both the UK mortgage and savings markets