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UK Financial Institutions: Proposals for New Senior Managers and Certification Regimes

With a mandate from Parliament, the UK regulators are working on a new regime governing individuals in banks.

The UK Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) published a joint consultation paper (the Joint Paper)[1] in July 2014 with the aim to increase the standards of personal accountability and strengthen the regulation of individuals who work in banks, building societies, credit unions, and PRA-designated investment firms.

The proposals encompass a new senior managers regime for directors and other senior individuals and a certification regime for more junior employees. Alongside these changes will sit new conduct rules issued by both the FCA and PRA that will regulate individuals' behaviour. These two regimes will replace the current approved persons regime and current statements of principle and code of practice for approved persons.

The proposals build on recommendations made by the Parliamentary Commission on Banking Standards (PCBS)[2] in its report *Changing Banking for Good* published in June 2013. In short, PCBS found that under the current regime, there was little prospect of effective enforcement against individuals, mainly because too narrow a range of individuals were covered and responsibilities were not in practice attributed to individuals. The Financial Services (Banking Reform) Act 2013 (the Act) contains the framework for the new regime, which will apply to the following:

- UK-incorporated banks, building societies, and credit unions
- UK-incorporated and PRA-designated investment firms (collectively, banks)

On 17 November 2014, HM Treasury, in exercise of its powers under the Act, issued its own consultation in the area aimed at widening the scope of the new regime to capture personnel within UK branches of overseas banks.

Senior Managers Regime

The Joint Paper proposes a new approval regime for senior managers whose actions and decisions would have a significant impact on the banking sector and customers. This will include the bank's board of directors; executive committee members (or equivalent); heads of key business areas that satisfy certain criteria; individuals who are responsible for important business-, control-, or conduct-focused functions within the bank; and those individuals employed by a group or parent company who exert significant influence over the bank's decision making.

Individuals who perform a senior management function specified by PRA would require pre-approval by PRA with FCA's consent; where the function is FCA-specified, pre-approval by FCA only will be required. As part of the transition, individuals who are currently approved persons and covered by the new regime will be "grandfathered" into the new regime. The application to the FCA or PRA for approval must be accompanied by a statement of

1. PRA CP14/14 and FCA CP14/13 - Strengthening accountability in banking: a new regulatory framework for individuals.
2. PCBS was established in 2012 to inquire into professional standards and culture in UK banks and to make recommendations.

responsibilities that sets out the areas of the bank for which that individual will be responsible. The statement is a vital part of the approval process and must be resubmitted to the relevant regulator whenever there is a significant change in the individual's responsibilities.

Certification Regime for Junior Employees

The Joint Paper also includes a certification regime, which will apply to employees who are not subject to the senior managers regime but who still perform a role related to regulated activities and can therefore cause significant harm to the bank or its customers. For PRA, the certification regime will apply to material risk-takers, and for the FCA, it will apply to those in customer-facing roles, individuals who supervise certified persons, and any other role not covered by the senior managers regime, such as benchmark submitters. Senior managers will be responsible for the assessment and certification of the relevant junior employees and be required to assess their fitness and propriety annually, which will involve banks in significant due diligence.

Fitness and Propriety

The Act obliges banks to establish that candidates for senior manager or certification functions are fit and proper to perform the role for which they are applying and thereafter to make annual assessments of such, to report senior managers who fail that assessment to the regulators, and to refuse to renew the certificate of employees who fail that assessment. There is already FCA guidance on assessing fitness and propriety, and FCA proposes to continue with that. PRA will produce its own guidance, but its underlying substance is not expected to change.

Conduct Rules

The Joint Paper proposes a set of conduct rules that would apply not only to all senior managers and their respective populations within the certification regime but also to all other bank employees, except those who carry out purely ancillary functions (a wider group than employees subject to the certification regime). The FCA and PRA have each proposed their own set of substantially similar rules, which, happily, largely draw on current rules.

The rules are split into two tiers. Tier One, the Individual Conduct Rules, apply to all roles in which individuals are subject to the two new regimes described above. Tier Two, the Senior Manager Conduct Rules, apply merely to those covered by the new senior managers regime (in addition to Tier One).

Under Tier One, individuals must

- act with integrity;
- act with due skill, care, and diligence; and
- be open and cooperative with the FCA, the PRA, and other regulators.

Under Tier Two, Senior Managers must also

- take reasonable steps to ensure that the business of the firm for which they are responsible is controlled effectively;
- take reasonable steps to ensure that the business of the firm for which they are responsible complies with relevant requirements and standards of the regulatory system;
- take reasonable steps to ensure that any delegation of responsibilities is to an appropriate person and to oversee the discharge of the delegated responsibility effectively; and
- disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

Enforcement

On enforcement, if a bank contravenes a relevant requirement, the burden of proof is reversed so that the senior manager responsible for the area where the contravention has occurred could be held accountable if they are unable to satisfy FCA and PRA that they have taken “reasonable steps” to prevent or stop the breach. The Act allows FCA and PRA to take disciplinary actions for breach of conduct rules against a much broader range of bank employees than under the current regime. This should enable FCA and PRA to pursue wrongdoing wherever it is found.

Furthermore, senior managers who work in UK-incorporated banks, building societies, and PRA-designated investment firms face potential criminal liability under a new offence relating to a decision causing a financial institution to fail. HM Treasury has decided not to make senior managers of UK branches of overseas banks subject to that offence.

Responsibilities Map

The FCA and PRA propose that banks maintain a detailed and up-to-date responsibilities map that outlines banks’ management and governance arrangements, including, among other things, the allocation of general management responsibilities, the reporting lines, and an organisational structure.

Timetable

The consultation period on the Joint Paper expired on 31 October 2014, with the expectation that final rules would be published by the end of the year. However, the recent consultation by HM Treasury (which expires on 30 January 2015) means that the timetable to implementation will be pushed well into 2015. It is likely that FCA and PRA will publish a further joint consultation paper that sets out their proposed approaches to implementing the new regime in UK branches of overseas banks, but not until the outcome of the HM Treasury consultation is known. Broadly, PRA will likely take a lighter approach with UK branches, given its focus on prudential regulation, and FCA will likely take a substantially similar approach to the one proposed for UK banks.

We will continue to follow these developments closely.

Contacts

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