

## Senior managers regime (SMCR): government u-turn on presumption of responsibility

The Senior Managers and Certification Regime (SMCR), which has headlined regulatory news over the past fourteen months, is currently undergoing major developments at government level prior to its official implementation on 7 March 2016. The regime proposes to address the shortcomings in professional standards within the banking sector by imposing stricter regulatory control and greater transparency within firms responsible for managing risk, write William Yonge from the London Investment Management practice, and Lee Harding and Matthew Howse from the London Employment practice of global law firm Morgan Lewis.



HM Treasury has recently announced that the SMCR, which is currently targeted at banks, is to be extended to the wider financial services industry in 2018. In 2014 former members of the Parliamentary Commission on Banking Standards called for the regime to be extended, as did the Fair and Effective Markets Review this year. HM Treasury argues that the extension of the SMCR “will create a fairer, more consistent and rigorous regime for all authorised financial services firms.” The proposal follows a series of recent attempts by regulators and government officials to crack down on poor industry standards and to tighten accountability amongst individuals at the top of financial services firms.

The announced abolition of the “Presumption of Responsibility” came as a shock. Under the Presumption of

Responsibility, a senior manager was deemed to be individually accountable for his/her senior management function in which a contravention occurred, unless he/she could prove that all reasonable steps had been taken to prevent or mitigate the wrong-doing. Failure to do so could have resulted in enforcement action being taken against the senior manager personally. This was a highly controversial aspect of the Banking Reform Act 2013 when it was introduced.

On 14 October 2015, the Bank of England and Financial Services Bill was introduced in the House of Lords with provisions to extend the regime beyond banks, abolish the Presumption of Responsibility and various other amendments.

### **The SMCR in short**

The PRA and FCA have specified up to 17 senior management functions (SMFs) which firms need to allocate to their senior managers. Where a SMF is allocated to a senior manager, the responsibilities associated with that SMF must be set out in a statement of responsibilities. Firms must also document each SMF within a responsibilities map. This is intended to remove practical barriers to enforcement and make it easier for regulators to hold senior managers personally accountable for a failing of an SMF. Firms must get the prior approval of the relevant regulators before a senior manager can be responsible for a SMF.

The Certification Regime component will apply to individuals employed in positions other than SMFs where they could pose a risk of significant harm to the firm or any of its customers. This regime will cover the next level of management and any "material risk takers" to ensure that anybody with the ability to cause "significant harm" within a firm is fit and proper. The regime will require firms themselves to assess the fitness and propriety of these individuals both at the recruitment stage and on an annual basis but appointments for certified function holders will not be subject to prior regulatory approval.

The regulators will also impose a set of conduct rules with which the majority of a firm's staff will be expected to comply. The rules will provide the framework against which the regulators can judge an individual's actions.

### **The extension of the SMCR beyond the banking and insurance sectors**

Currently the scope of the SMCR captures banks (including UK branches of foreign banks), building societies, investment banks and credit unions. The regime will come into force on 7 March 2016. The Senior Insurance Managers Regime (SIMR), a bespoke regime applicable to insurers, will also come into force on 7 March 2016. In 2018, the SMCR will be extended to encompass all other regulated financial institutions. Intriguingly, HM Treasury has indicated that the SMCR will apply to insurers as of 2018, which suggests a short shelf-life for the SIMR.

By 2018, approximately 200,000 individuals at around 60,000 UK financial service firms will be caught by the extended SMCR. The key features of the regime will be applied subject to the principle of proportionality, which should help reflect the diverse business models operating in the UK and help mitigate the impact on smaller firms.

### **The proposed abolition of the “Presumption of Responsibility”**

On 15 October 2015, HM Treasury announced plans to scrap the Presumption of Responsibility and to replace it with the “Duty of Responsibility.” This will impose a statutory duty on senior managers to take reasonable steps to prevent regulatory breaches in their area of responsibilities. The burden of proving misconduct will however fall on the regulators, as with other regulatory enforcement actions. Tracey McDermott, acting CEO of the FCA, described the Presumption of Responsibility as ‘one, small element of the reforms,’ in sharp contrast to the emphasis placed on it by her predecessor, Martin Wheatley, who described it as “key tool” to allow the FCA to take action against individuals who do not properly discharge their responsibilities.

The abolition of the Presumption of Responsibility cannot be isolated from Government’s desire to extend the SMCR across the entire financial sector. Helpfully, Government has acknowledged that it would be disproportionate to apply the Presumption of Responsibility to the smaller and less complex financial institutions which will be brought into the extended regime in 2018.

It has been suggested that its abolition is to ensure that the SMCR could be enforced without possible legal challenges as to whether the rules breached European human rights laws. Government also stated that the Presumption of Responsibility would mean that firms would “incur greater costs” for compliance while Ms McDermott has suggested that it “risked distracting senior management within firms from implementing both the letter and spirit of the regime.”

The House of Lords has put forward fierce opposition to the proposal to abolish the Presumption of Responsibility. During the second reading of the Bill on 26 October, Lord Eatwell described the abolition as Government's "spineless surrender to industry lobbying on the issue of the burden of proof in the senior person's regime."

This article was originally published in **FX-MM**

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