

Senior Managers and Certification Regime: extension to all FSMA authorised persons

HM Treasury

RPC rating: fit for purpose

Description of proposal

The Government introduced the Senior Managers and Certification Regime (SM&CR) to strengthen the accountability of senior managers in the banking sector.

HM Treasury proposes to make the following amendments to the existing SM&CR, and to extend the regime to authorised financial services firms outside banking in 2018:

- Introducing a statutory duty of responsibility, superseding the existing ‘reverse burden of proof’ such that in cases of alleged contravention, the burden of proof will fall on the regulators not on the senior manager.
- Removing an SM&CR obligation for banking sector firms to notify the regulator if they know or suspect that employees have breached rules of conduct that apply to them.
- Allowing the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) to make enforceable rules of conduct for non-executive directors.

HM Treasury explains that the proposal will bring approximately 60,000 additional firms of varying sizes and types into the scope of the SM&CR. These include insurers, investment firms, asset managers, insurance and mortgage brokers, and consumer credit firms. HM Treasury explains that the changes above are intended to ensure the SM&CR is appropriate for the variety of financial sector firms outside of traditional banking, so that a consistent and fair regime can be applied across the whole industry.

Impacts of proposal

The IA explains that “*the impact of extending the SM&CR will only arise when detailed rules to implement the reforms are made by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA)*” (page 3). The regulators will therefore make rules of conduct setting out the functions that will fall into each of the categories as defined in the primary legislation. All of the costs and benefits of the

SM&CR are, therefore, dependent on the detail of the rules set by the regulators. A further impact assessment covering the impacts of implementing the SM&CR will be submitted for RPC validation once the regulators have developed their proposals, in consultation with industry.

To provide an indicative estimate of the costs and benefits of the proposal at this stage, HM Treasury has used:

- data from the FCA's consultation paper on the SM&CR rules for banking;
- data from the FCA on the size of the various firms affected; and
- a set of assumptions about the relationship between the size of the firm and the impacts of the proposal.

Costs to non-banking firms

The main cost of the proposal arises from extending SM&CR to financial sector firms outside banking. The introduction of the SM&CR will require firms to:

- set up the appropriate systems to operate the regime;
- ensure checks are made and recorded;
- ensure that firms can track relevant individuals; and
- train those individuals in the rules that apply to them.

HM Treasury expects no significant ongoing costs associated with certification as firms are expected to integrate the initial certification of individuals into their recruitment processes and carry out annual certification as part of their annual appraisal cycle. Any ongoing costs associated with training in rules of conduct are expected to be covered in normal HR processes. However, any training required will be dependent upon the forthcoming content of the regulators' rules of conduct. HM Treasury estimates making the remaining changes will result in a total one-off cost to business of £347.5 million, and ongoing costs of £9.7 million in 2018 and annual costs of £19.4 million in subsequent years.

Benefits to non-banking firms

HM Treasury expects that the introduction of the SM&CR will, in relation to insurers, investment and consumer credit firms, reduce the number of posts where appointments are subject to prior regulatory approval by between 68,100 and 80,600. This is because HM Treasury expects the SM&CR to be more flexible than the existing Approved Persons Regime in how firms structure and allocate resources at a senior management level. HM Treasury estimates a benefit of £2.73 million in 2018 and an annual benefit of £5.45 million in subsequent years.

Benefits to banking firms

HM Treasury explains that the proposal will remove two measures originally included in the SM&CR measures for banking sector firms. The IA explains that the removal of the breach reporting requirements will save banking firms, already in scope of the SM&CR, from incurring costs of £2.89 million in 2016, and £3.85 million in subsequent years. However, as these measures never came into effect, their removal from SM&CR legislation will not be scored as a benefit for the purposes of the business impact target. A discussion of these changes is included in the IA to complete the policy narrative.

Wider benefits

HM Treasury expects the proposal will improve market integrity, and reduce misconduct and financial crime in wholesale markets. These benefits have not been monetised.

This measure will be a qualifying regulatory provision that will score under the business impact target. At this stage, HM Treasury provides an indicative estimate of an equivalent annual cost to business of £48.5 million.

Quality of submission

A previous submission of this proposal contained three issues that meant that the RPC did not consider the IA to be fit for purpose. At this stage, all three issues have been adequately addressed.

Justification of assumptions

The majority of the assumptions used in the analysis in the previous submission were not tested with the relevant business stakeholders. However, the current submission explains that a subsequent IA will be submitted to the RPC following public consultations on draft rules by the regulators. The IA notes that *“this work will help inform a further IA to give a more detailed and robust assessment of the costs that will be associated with the regime when it comes into operation”* (page 7). HM Treasury, the FCA and the PRA must use these consultations to test and refine the assumptions used in the analysis to provide a more robust estimate of the EANDCB.

Small and micro business assessment (SaMBA)

The SaMBA in the previous submission contained two issues that have been adequately addressed at this stage.

Firstly, the SaMBA did not provide evidence or analysis to support the view that the implementation of the proposal will not have a disproportionate impact on the variety of small and micro businesses in the financial services sector. In relation to the senior managers regime, HM Treasury explains that preparing statements of responsibilities is relatively more burdensome in large firms as costs increase the more senior managers there are in a firm, and the more complex the hierarchy. In relation to the certification regime and introduction of rules of conduct, HM Treasury explains that for small and micro businesses “*it will be easier and more straightforward for these firms to identify the roles and individuals to whom certification and conduct rule requirements apply and therefore to make fitness and propriety checks, to issue certificates and to notify and train individuals in conduct rules*” (page 17). HM Treasury, the FCA and the PRA must use subsequent public consultations to seek evidence from stakeholders on whether the regulators’ proposed implementation of the regime will be disproportionately burdensome. In particular, the public consultations must be used to test whether small and micro businesses will face disproportionately high costs due to typically having smaller compliance teams and relatively higher familiarisation costs. This evidence must be contained in the subsequent impact assessment.

Secondly, the SaMBA did not provide a discussion of the extent to which HM Treasury expects small and micro businesses to be able to comply with the costs they would incur under the proposal. HM Treasury have now provided estimates of the one-off and compliance costs for an average investment firm and consumer credit firm. At this stage, HM Treasury estimates the SM&CR will impose one-off costs of between £6,880 and £8,320 for an average investment firm and between £3,400 and £4,360 for an average consumer credit firm. Ongoing annual costs of between £740 and £780, and £140 have been estimated respectively for these firms. HM Treasury, therefore, concludes costs are “*unlikely to be significantly more onerous than is currently required for an approved person application*” (page 18). HM Treasury, the FCA and the PRA must test these estimates at consultation, and the subsequent assessment must provide evidence from stakeholders on the implications of these compliance costs for small and micro businesses.

Other points

The subsequent assessment on the implementation of the SM&CR must also strengthen the analysis in a number of areas. In particular:

- Justify, with reference to stakeholder evidence, why “*it assumed there will be no additional ongoing costs as training in rules of conduct will be covered in normal HR processes*” (page 12).

- Provide a discussion clarifying whether the “*relevant training*” (page 13) associated with the extension of the SM&CR covers familiarisation costs.
- Explain why it has been assumed that “*the change in requirements would take place part way through the year*” (page 8), leading to lower costs and benefits in 2018 than in subsequent years, or refine this assumption accordingly.
- Clarify why Annex A estimates that the proposal will bring 92,300 additional senior managers in scope of the SM&CR (page 19), while the body of the IA estimates that the proposal will bring 158,300 additional senior managers in scope (page 12).
- Provide a discussion on any costs to new firms in the sector, using churn data, where possible, to estimate these costs.
- Justify, with reference to stakeholder evidence, why “*the additional ongoing costs to firms of certification costs are expected to be negligible*” (page 11), and why the ongoing costs arising from submitting and processing applications are estimated to be zero (page 9).
- Explain the extent to which regulators will recover their costs from implementing the SM&CR from firms, and revise the estimated costs to business as appropriate.

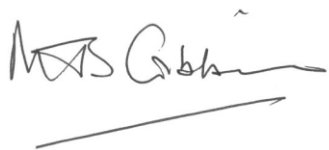
Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net cost to business (EANCB)	£48.5 million
Business net present value	-£446.9 million
Societal net present value	-£446.9 million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated	Impact on business will be validated in a subsequent assessment covering the implementation of the SM&CR
Small and micro business assessment	Sufficient at this stage

Opinion: final stage
Origin: Domestic
RPC reference number: RPC-HMT-3143(2)
Date of implementation: 2018



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