

# The Financial Services and Markets Act 2023: The Senior Managers and Certification Regime (SM&CR) – where are we headed?

November 9, 2023

On 9 December 2022, the Chancellor of the Exchequer made a series of announcements which relate to reforms (at various stages of development) to drive growth and competitiveness in the financial services sector, commonly known and referred to as the "Edinburgh Reforms".<sup>1</sup> These announcements involve numerous policy initiatives focused on delivering the government's ambition for the UK to be the world's most innovative and competitive global financial centre. It marked a new chapter in its financial services history post-Brexit and has set the agenda for the UK's financial services framework for years to come.

At the heart of what the government has said it will do is to embark on the task of repealing retained EU law in financial services and replacing it with rules designed to more appropriately reflect UK market conditions. In large part, this process will be delivered through powers set out in the Financial Services and Markets Act 2023 (the **Act**) which follow the Future Regulatory Framework Review (**FRF**).<sup>2</sup> However, the Act is not focused solely on reform of retained EU law, but also delivers a number of substantive reforms to the regulation of financial services which are unique to the UK and not derived from EU law. One of the most significant of these reforms is the extension of the Senior Managers & Certification Regime (**SM&CR** or the **regime**) to financial market infrastructure firms.

This article focuses on the announcement to commence a review into reforming the regime which HM Treasury, the Prudential Regulation Authority (**PRA**) and the Financial Conduct Authority (**FCA**) commenced in Q1 2023 and how this review fits with the reforms given effect through the Act. This article will:

- explain the SM&CR at a high level, including the most recent measure in the Act which extends (or enables the government to extend) its application to financial market infrastructures, recognised stock exchanges and credit ratings agencies;
- set out the details of the review taken since the announcement made on 9 December 2022; and
- highlight our key takeaways on what this means for the SM&CR going forward.

## What is the SM&CR?

Following the financial crisis of 2008, the Parliamentary Commission on Banking Standards recommended the introduction of a mechanism to hold senior managers at banks more personally accountable for actions within the bank. The SM&CR is the result. The SM&CR is an individual accountability framework that consists of three interlocking elements which require individuals who hold senior manager functions to take greater responsibility for actions that fall under their area of responsibility. This has the effect of helping the regulators to hold those individuals at financial institutions and services firms to account. For banks and insurers, the SM&CR replaced the approved persons regime in March 2016 and December 2018, respectively. It was extended to FCA solo-regulated firms in December 2019.

The three interlocking elements in the SM&CR are:

- the Senior Managers Regime (**SMR**);
- the Certification Regime; and
- the Conduct Rules.

## The SMR

The purpose of the SMR is to ensure that key responsibilities, called senior management functions (**SMFs**), within financial institutions are assigned to specific individuals, who are made fully and unambiguously aware of those responsibilities and are personally held to account for how the institution discharges functions within those areas of responsibility. The relevant financial services regulator specifies the SMFs according to firm type and the firm is responsible for recruiting a person who is "fit and proper", but the regulator has to approve such appointment. These obligations apply regardless of whether the role-holder is physically based in the UK or overseas. Firms must clearly allocate applicable responsibilities under this regime to ensure that there is an individual senior manager accountable for every aspect of regulated activities within the firm.

A core requirement is that the most senior decision-makers in firms should be fit and proper for their roles and take reasonable steps in the execution of their duties. The regime also aims to ensure that all financial services staff meet expected conduct standards. We summarise each component as follows.

## The Certification Regime

The Certification Regime applies to individuals who could pose a risk of "significant harm" to the firm or any of its customers, such as staff who provide investment advice. Under this regime, firms themselves must certify that these individuals are fit and proper for their roles at the beginning of their employment and on an ongoing basis.

## The Conduct Rules

The Conduct Rules apply to the conduct of employees of SM&CR firms based in the UK or who deal with customers in the UK. Firms must ensure that all employees subject to the Conduct Rules are notified of the rules that apply to them and take reasonable steps to ensure that those persons understand how they apply to them.

# Application of the SM&CR

The SM&CR applies to banks and insurers (regulated by the PRA), as well as three categories of FCA solo-regulated firms:

- enhanced firms (subject to the most requirements but the least number of firms fall into this category);
- core firms (majority of solo-regulated firms); and
- limited scope firms (subject to the fewest requirements).

The SM&CR is a creature of the UK and not derived from (or retained) EU law. Internationally, since its inception, the SM&CR has been applauded for establishing the UK as a global leader in regulation and individual accountability. Notably, Australia, Singapore, Ireland and Malaysia have introduced or started to develop regimes that have in some part been modelled on the UK regime.<sup>3</sup> Notwithstanding this, the government has expressed its openness to learning from the examples of others and, in particular, whether another international regime has an impact on the UK's

relative attractiveness as a destination for financial services business.<sup>4</sup>

# What has happened since the Edinburgh Reforms announcement?

Following the December 2022 announcements, HM Treasury launched **a call for evidence** (Call for Evidence) to look at the legislative framework underpinning the regime on 30 March 2023. Alongside the Call for Evidence, the FCA and PRA published a joint paper, **DP23/3: Review of the Senior Managers and Certification Regime** (the DP, together with the Call for Evidence (the Review)) which invites discussion around the operational aspects and rules of the SM&CR. This is effectively an information gathering exercise from HM Treasury and the regulators to seek stakeholder views on the effectiveness, scope and proportionality of the SM&CR to date.

The Review closed on 1 June 2023 and is the first full review of the SM&CR. While there have been other reviews in the past, these were more limited in scope.<sup>5</sup>

## The Review

### The Call for Evidence

The Call for Evidence opens with a statement that "...the government understands there is broad support for the principles and objectives underpinning the regime".<sup>6</sup>

Asking respondents to raise issues with respect to any part of the regime acknowledges that firms operating within the regime have raised concerns on aspects of SM&CR with the government. These include compliance requirements for authorising the appointment of new senior managers, the differing levels of scrutiny applied to different firms, and the interaction of the SM&CR with other regulatory regimes.<sup>7</sup>

The government has set SM&CR reform in the context of its wider agenda on international competitiveness, acknowledging that SM&CR compliance can have an impact on attracting talent into the UK,<sup>8</sup> and is keen to understand views from industry on the impact the SM&CR has on the UK's international competitiveness, including whether there are options for reform that could improve the UK's competitiveness.<sup>9</sup>

The tenor of the Call for Evidence is less about root and branch reform of the SM&CR, although it does ask whether the core elements continue to work, but is more about whether the regime can be made to operate more efficiently and effectively.

### DP23/3

The DP asked respondents to provide responses to 22 questions, 11 of which consider the extent to which SM&CR is meeting its objectives, with scope and proportionality of the regime in mind, while the other 11 consider the three key parts of the SM&CR and how specific improvements could be made operationally.<sup>10</sup>

The DP also set out a number of concerns that have been raised informally by stakeholders, including:

- the authorisation process and timing for appointment of senior managers – the delays in the approval process for some time have meant that there are issues around business planning, but note regulators have said they have increased capacity and capability for functions for approval to deal with this issue;<sup>11</sup>
- the breadth of coverage of the Certification Regime;

- different levels of scrutiny applied to firms regulated under the regime;
- the interaction of the SM&CR with other regulatory regimes;
- aspects of the regime which may appear removed from its core purpose of managing risk; and
- the frequency with which certification must be reviewed.<sup>12</sup>

Both papers in the Review acknowledge that the SM&CR is primarily a proactive, preventative regulatory regime designed to manage appointment, enhance accountability and prevent breaches of conduct. This acknowledgment may be read as an attempt to address echoes in industry for some time now that the SM&CR lacks bite<sup>13</sup> and that there is little jurisprudence available to understand the scope of the regime or to provide guidance on how the regime should apply operationally. As a result, the FCA and PRA have sought views and feedback on the extent to which the possibility of investigation and/or enforcement actions has consequences for the way in which firms undertake remedial action once risks start to crystallise.<sup>14</sup>

Reflecting the expectation that the Review is unlikely to change the fundamental elements of the SM&CR, continuing support for the SM&CR can also be seen in its latest extension through the Act, which received Royal Assent on 29 June 2023, to those financial markets infrastructure firms which are considered to be critically and systemically important and which underpin the UK's economy and financial system.<sup>15</sup> Schedule 10 introduces sections 309A to 309Z8 which apply the regime to exempt persons in Chapter 18 (Central Counterparties, Central Securities Depositories and Recognised Investment Exchanges) with a gateway regime installed to enable switching the regime on as and when needed (including for credit ratings agencies). The extension of the existing regime to these entities was designed with proportionality and effectiveness in mind, recognising that each type of entity will inevitably have different characteristics which need to be factored in. This is in line with the SM&CR regime, which was not designed to be a one-size-fits-all approach.

It is worth mentioning that most firms which responded to the PRA's 2020 evaluation felt the SM&CR was sufficiently proportionate to reflect their size and complexity, although the percentage favourably (while a majority in each case) was greater in the case of large firms than medium and smaller-sized firms. More recently, respondents to the PRA's DP1/21 on the Strong and Simple Prudential Framework for Non-Systemic Banks and Building Societies favoured some simplification of the SM&CR, in terms of either minimum requirements, thresholds or processes for approving new individuals.<sup>16</sup>

## Our takeaways regarding where we are headed with the SM&CR

Which all leads us to the question...where are we headed with the SM&CR in light of the Review and the extension of the regime under the Act? Should we expect a paradigm shift on SM&CR or simply a fine-tune to make it more efficient and effective in order to further the international competitiveness of the UK's financial services sector?

Whilst no public statements have been made and all options must remain on the table, the terms of the Review and the views from financial services firms appear to envisage a fine-tuning of the regime rather than a root and branch reform. This would dovetail with the fact that the regime has been extended to financial markets infrastructure firms.

Our main takeaways are as follows:

- Assuming that there are no root and branch reforms of the wider SM&CR, the provisions in the Act are unlikely to be amended and each new regime will be introduced as originally envisaged. Whilst the extension of the SM&CR to

FMI firms was designed to be proportionate to the activities of those firms to which it will apply, there may be operational tweaks which are implemented as a direct consequence of the Review. We anticipate that any future SM&CR plans for payments and e-money firms will be put on hold pending the outcome of the Review. <sup>17</sup>

- Although HM Treasury and the regulators have identified some known problems, the consultations themselves do not suggest that fundamental changes to SM&CR are likely and keen followers of the SM&CR will recall that the regulators reviewed the SM&CR implementation in 2019/20 (albeit much more limited in scope) which did not result in any changes (with the Review now reiterating how successful the SM&CR has been in the UK and internationally).
- If there are going to be any material changes, this could have a domino effect on other recent regulatory developments such as the new Consumer Duty – any material changes to the SM&CR might require more regulatory change project work and additional expenditure for businesses (alongside what arises from the other announcements from the Edinburgh Reforms).
- Whilst there has been for some time plenty of criticism about the lack of enforcement activity under the SM&CR, resulting in little guidance and lessons learned for industry, reading between the lines the Call for Evidence has sought to address this by emphasising that the SM&CR was intended to be a gateway and proactive regime. This message is emphasised throughout the Review and does not suggest that the government will be introducing new (or enhancing existing) enforcement tools for regulators any time soon.
- Overall, it would appear that the proposals regarding the SM&CR in both the Act and the Review are likely to result in evolutionary developments in the SM&CR regimes, rather than revolutionary changes but let's see what happens after the FCA and the PRA have considered the responses to DP23/3.

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  2. Consultation Outcome: Future Regulatory Framework (FRF) Review: Proposals for Reform: <https://www.gov.uk/>↩
  3. Prudential Regulation Authority Appendix to DP1/23 Review of the Senior Managers & Certification Regime Discussion Paper, March 2023: <https://www.bankofengland.co.uk/>↩
  4. HM Treasury, Senior Managers & Certification Regime, Call for Evidence, March 2023: <https://assets.publishing.service.gov.uk/>.↩
  5. See the FCA's Senior Managers & Certification Regime Banking Stocktake Report, 5 August 2019, <https://www.fca.org.uk/> and the PRA's Evaluation of the Senior Managers & Certification Regime, December 2020, <https://www.bankofengland.co.uk/>.↩
  6. See paragraphs 1.2 and 3.7 of Senior Managers & Certification Regime, Call for Evidence, March 2023 <https://assets.publishing.service.gov.uk/>↩
  7. HM Treasury, Senior Managers & Certification Regime, Call for Evidence, March 2023: <https://assets.publishing.service.gov.uk/>↩
  8. See paragraphs 1.6 and 3.14 to 3.17 of Senior Managers & Certification Regime, Call for Evidence, March 2023.↩
  9. Question 5 in Senior Managers & Certification Regime, Call for Evidence, March 2023.↩
  10. See section 5, Questions: DP1/23 – Review of the Senior Managers & Certification Regime, 30 March 2023: <https://www.bankofengland.co.uk/prudential-regulation/>↩
  11. HM Treasury, Senior Managers & Certification Regime, Call for Evidence, March 2023: <https://assets.publishing.service.gov.uk/>↩
  12. See paragraph 3.22 of Senior Managers & Certification Regime, Call for Evidence, March 2023 <https://assets.publishing.service.gov.uk/>↩
  13. SMCR investigations halve, despite extension to almost 50,000 firms (Ben Blackett-Ord, chief executive officer at Bovill), 28 March 2022: <https://www.bovill.com/uk-europe/>↩
  14. Prudential Regulation Authority Appendix to DP1/23 Review of the Senior Managers & Certification Regime

Discussion Paper, March 2023: <https://www.bankofengland.co.uk/>. ↩

15. Senior Managers & Certification Regime: Financial Market Infrastructures, July 2021:

<https://assets.publishing.service.gov.uk/>. ↩

16. Feedback Statement FS1/21 Responses to DP1/21 "A strong and simple prudential framework for non-systemic banks and building societies", December 2021: <https://www.bankofengland.co.uk/> ↩

17. FCA Perimeter Report 2020/21, 21 October 2021, <https://www.fca.org.uk/>. ↩

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