SMCR for SMFs

Introduction

As the Senior Managers and Certification Regime ("SMCR") requirements are extended to nearly all firms regulated by the FCA on 9th December 2019, we thought it would be an opportune moment to consider some of the challenges banks have faced and the subsequent lessons learned.

It is not only the additional firms to whom SMCR will be applicable from December who are concerned. The EU branches operating in the UK have previously been subject to a lighter version, with less SMF functions applicable to them. As they transition to third country branches, or even subsidiaries, if and when Brexit happens, there will be more SMF functions applicable to them and greater scrutiny.

There was no shortage of legal advisors and consultants supporting the banks with implementation, but SMCR is more than just a documentation exercise, as Senior Management Function ("SMF") executives are only too aware of.

As regulatory scrutiny of SMFs increases, we have set out the key areas we think firms, and individuals, should be focusing on to ensure they can demonstrate they are taking 'reasonable steps' and remain protected.

Culture remains critical to ensure the right outcomes are achieved, which means firms should be considering drivers of behaviour, governance, training, performance management, and incentives as part of their SMCR implementations.

SMFs should be proactive in reviewing and challenging the culture across both the teams that directly report into them, as well as teams where they have assigned delegated authorities. We consider the key lessons learned and some of the areas SMFs should be considering when taking reasonable steps to execute their responsibilities.

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Challenges and Lessons Learned

Based on the experiences from the banking sector, we have set out some of the challenges we have identified, as well as lessons learned. SMCR implementation should be viewed as an evolution: there is no end point.

As organisational risks evolve, with market, technology, and regulatory changes, so too will the way in which SMFs execute their responsibilities. However, there are common challenges SMFs face across firms.

Aligning responsibilities and risks

Banks, as expected, have developed detailed responsibilities maps and detailed frameworks evidencing compliance with SMCR. The real challenge comes in ensuring the firm's risk management and regulatory framework, and ownership of risk, is aligned to what the responsibilities maps say.

Firms continue to run separate processes, where the SMCR framework is developed independently of the risk management framework and SMF responsibilities do not fully align to risks. Only by achieving this alignment and designating specific taxonomies to SMFs can the appropriate level of ownership be achieved (and importantly evidenced).

Data and Management Information ("MI")

In order to execute their responsibilities effectively, SMFs need access to the right data and MI. Often, this has resulted in manual processes (prone to operational errors) to collate reams of data, which is difficult to review, analyse, and use.

Given the level of data firms now collect and process, as well as the easy availability of data visualization tools, it will become difficult to blame data quality or poor MI for not identifying an issue. SMFs should take time to consider what data they want and work to get it.

Escalation of Issues

Ensuring issues are escalated to the SMF responsible, and the correct governance forum, is critical. Time and time again, we are still seeing known regulatory issues, for example in respect of MiFID II implementation, not being actively addressed or escalated.

Culture is critical. SMFs have a responsibility to ensure both their direct reports and their delegates are cascading the right culture. As more firms face budgetary constraints, it becomes even more important for individuals to understand they are expected to identify and escalate issues.

Risk Acceptance

Too much risk acceptance is still happening day to day, within individual teams. This leaves SMFs exposed. Firms may not have sufficient resources to ensure that there are robust controls across all risks, however risk acceptance should be formally agreed and documented to ensure SMFs are protected, if and when a risk crystallises.

Although there has been some regulatory action by the FCA already, SMFs need to ensure they are not caught out as regulatory scrutiny increases.

Managing Delegations

SMFs in banks are relying on delegations, as new SMFs no doubt will post 9th December. Individuals need to ensure that delegation is not viewed as an outsourcing of their responsibility.

SMFs remain responsible for providing oversight, particularly by way of review and challenge to ensure their delegated responsibilities are being performed in the same manner as they would have been performed within their own teams. This means SMFs need access to the right data and metrics, as well time with the relevant individuals to execute their oversight responsibilities.

When delegating, SMFs need to ensure they are comfortable with the knowledge, skills, and experience of the individual to whom they are delegating. This also needs to be periodically assessed.

Delegation does not mean the SMF does not need to worry about the risk.

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What does 'Reasonable Steps' look like?

Based on the challenges we have identified, and the SMCR requirements, we have set out below a few areas that we think are critical for SMFs to consider when ensuring they are taking 'Reasonable Steps' to execute their responsibilities.

Governance

- Each SMF should be aware of what they are responsible for and their areas of responsibility and accountability should be clearly documented.
- Direct reports of SMFs should understand what their responsibilities are and they should be assessed against these responsibilities as part of the performance management process.
- Accountability extends beyond the prescribed responsibilities. Ownership of specific risks should be aligned to SMFs, as should sponsorship of material change programmes.

Regulatory Requirements and Risks

- Each SMF should be aware of the regulatory requirements for which they are responsible for ensuring compliance with.
- SMFs should understand, and actively put in place plans to deal with, upcoming regulatory changes impacting their areas of responsibilities.
- Ideally, regulatory requirements should be linked to a risk taxonomy to ensure SMFs can track exposure to potential breaches.

Risks and Controls

- SMFs should be aware of which elements of the regulatory, risk, and control framework they are responsible for.
- SMFs should ensure there are appropriate policies, procedures, and controls in place to manage the risks for which they are responsible. This includes ensuring the control framework is updated in line with regulatory changes.
- Breaches should be identified and remediated.

Delegations

- SMFs should ensure they have accurately identified which responsibilities are being delegated and to whom.
- SMFs should ensure they have assessed that the individuals to whom they are delegating have capacity to perform the delegated tasks and have appropriate knowledge, skills and ability.
- SMFs should ensure they are proactively identifying training needs of individuals.
- SMFs should ensure they retain appropriate oversight (including periodic review and challenge) of delegated responsibilities.

Culture

- SMFs should assess and ensure that they are comfortable with the culture across both their teams and the teams to whom they have delegated responsibilities.
- Focus should turn to middle management to ensure key messages are cascading through the organization.

Risk Acceptance

- In order to execute their responsibilities, SMFs need to ensure they are aware of all material issues within their remit.
- It may not be feasible, or even possible, to remediate all issues as they arise. However, SMFs should ensure that where they are accepting risk, this is done through an appropriate governance forum and is documented.