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Banking Standards Board response to Financial Conduct Authority Consultation CP17/25: Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms

Response to the FCA and PRA

The Banking Standards Board (BSB) welcomes the opportunity to respond to the FCA's consultation on extending the Senior Managers and Certification Regime (SMCR) and Conduct Rules to all FSMA authorised firms and the PRA's consultation on extending the SMCR to insurers. In this response, we describe our experience of working with BSB member firms to help the banking sector implement the Certification Regime in a way that raises standards of behaviour and competence in banking.

We also provide some insights that we have gained from working with member firms in the BSB's Certification Regime Working Group (CRWG). This group includes representatives of more than twenty BSB member firms, ranging in scale from universal banks to small firms including some new entrants. We hope that the practical insights into the implementation of the regulatory regime so far included in this response may highlight some of the opportunities and challenges that other firms may encounter in implementing the extended SMCR.

The SMCR and behaviour, competence and culture

The introduction of the SMCR for the original set of firms presented an opportunity for these firms to demonstrate that they were taking responsibility for ensuring high standards of competence and conduct among their employees. The extension of the regime provides a similar opportunity for other firms across financial services to do the same, and to learn from approaches that are now becoming established practice in the banking industry.

Conduct regulation can define what is prohibited or what is required as a minimum, but it cannot easily define what good looks like in all circumstances and at all times. Firms – in the organisational culture they create and the standards of behaviour and competence they expect – own the responsibility for how they operate.

Regulatory requirements are starting points, not end-points. The SMCR is an example of the complementary nature of regulation and firms' own practices. Extending this regime presents a significant opportunity for firms to build on regulatory baseline standards to raise professional standards across financial services.

A major aim of the SMCR is, as the FCA has noted elsewhere, to support and enable positive cultures. The regulation is clear in its requirement for firms to assess the 'fitness and propriety' (F&P) of certified individuals. It leaves, however, much of the detail of how this should be done to firms themselves. This provides the financial services sector with the chance to take the initiative and work, both individually as firms and collectively, to raise standards. One means of facilitating and, where appropriate, encouraging consistency of approach, is the identification of good practice; not in the sense of what a firm needs to do in order to declare itself compliant, but in the shape of what it can and should realistically aspire to do – and becoming more stretching, as initial aspirations are achieved.

The link between the SMCR and organisational culture is important. Should an event call into question an individual's F&P, firms should also as part of their evaluation of this event consider the organisational context in which it arose, and which may in turn highlight broader risks or issues that the firm needs to address.

The BSB's work on the Certification Regime

The BSB has focused primarily on assessing the F&P of certified staff and on the regulatory references regime. Since the latter requires firms to communicate with one another information that is relevant to F&P, it is in firms' interests to ensure that this information is generated and recorded efficiently and effectively. The purpose of our work on F&P has therefore been to:

- work with member firms that share the objective of making a success of the Certification Regime and of framing it positively around encouraging high standards of behaviour and competence, rather than treating implementation purely as a compliance exercise;
- discuss the overall goals of the regime, and identify barriers that firms are currently facing in seeking to achieve them (something that we also pick up as part of our related work on professionalism in banking, as well as in our assessments of competence, behaviour and culture in individual firms);
- provide a forum for discussing and collating current practices, and an environment in which firms can share difficulties and issues that they are facing; and
- from this, develop practical good practice guidelines that are intended to maximise the impact of the Certification Regime and support consistent application, which firms can then use as appropriate.

In developing this good practice, we have sought to:

- highlight the need for a fair and transparent process from the perspective of individuals;
- give firms a measure of confidence that F&P assessments being conducted by their peers are to a high standard, taking into account similar types of information;
- highlight the links between the Certification Regime and organisational culture; and
- use the Certification Regime as an opportunity to raise standards of behaviour and competence across the industry.

It is in this context that the BSB has been working on the implementation of the Certification Regime and related areas with our member firms since January 2016. We published the outputs of this work in February 2017 as our *Statement of Good Practice 1* on the *Certification Regime: Fitness and Propriety Assessment Principles* and *Supporting Guidance* on the *Certification Regime: Fitness and Propriety Definitions, Sources of Information and*

Assessment Record Template.[1] This guidance represents the pooling of knowledge of the BSB's member firms through our cross-industry Certification Regime Working Group.

In late 2016, the working group began to consider how decisions on F&P were being made within firms, and the different factors, risks and issues that were relevant to such decisions. The focus of this work has been on ensuring that the regime is effective in raising standards, and proportionate and fair to the individuals being certified; rather than on specific compliance or conduct risks or on defining regulatory minima. We published a draft of this good practice guidance for consultation in July 2017[2], and expect to publish the final guidance in early 2018.

The approach taken in this work may provide a helpful model for the development of voluntary good practice guidelines that build on regulatory initiatives to help realise the benefits of that regulatory change; benefits that would be difficult to achieve through regulation alone. Although our principles and good practice guidance are aimed at banks and building societies, we believe that this approach could be equally relevant to all SMCR firms.

Our work on F&P has had strong take-up among BSB member firms. Many firms have already told us that they have used BSB good practice guidance to develop policies, procedures and training in relation to the Certification Regime.

The link between regulation and implementation

The regulatory regime provides significant flexibility in terms of implementation, which has been welcomed by firms. This flexibility allows firms to tailor and scale the regime to their own business models and organisational cultures. While this is undoubtedly a benefit, it also however raises the possibility of inconsistency between different firms and their processes and approach, even when their objectives may be the same.

In collaboration with member firms, the BSB has identified areas where firms can build consistent good practices. One example of this has been work to examine in more detail the core components of F&P and identify the sources of information that firms might use to provide evidence of them. This work also produced a common set of F&P assessment principles framed so as to be sufficiently high-level for firms to adopt into their own processes, but challenging enough to encourage high standards (as well as a degree of consistency across the industry). The principles were designed to help identify good practice against which firms could test their own processes, policies and procedures.

In the course of developing and articulating good practice in this way, we have gathered a number of insights from member firms on the lessons and challenges that they have encountered when completing the first round of certification. Some specific areas where firms have sought to share good practice are:

- where they are required to make difficult subjective judgements about an individual's fitness and propriety without categorical evidence. This is particularly challenging in circumstances where evidence about an event may be incomplete or purely anecdotal;

[1] http://www.bankingstandardsboard.org.uk/bsb-fp-guidance/

[2] https://www.bankingstandardsboard.org.uk/bsb-launches-consultation-on-fp-risks-and-issues-draft-guidance/

- when assessing the F&P of individuals based overseas, particularly where local laws prohibit or make difficult accessing information that the firm would typically use to inform F&P assessments in the UK;
- when providing regulatory references. Some firms have expressed concerns that the information contained in regulatory references is variable across the sector, especially relating to historic conduct cases and incomplete disciplinaries; and
- when deciding whether to remove an individual's certificate or keep it in place with remediation or additional controls. This will to some extent depend on firms' individual risk tolerances or practical considerations, but is ultimately a judgement that balances the requirements of the regime, the specific details of the issue, and fairness to the individual (particularly in areas in which the individual has experienced a significant change of personal circumstances).

A common example of an issue that can be remediated given by the CRWG is financial soundness due to an unforeseen change in circumstances (e.g. when an individual's partner loses their job). When discussing their approach, most firms in our working group said that they:

- took a supportive approach as far as possible;
- focused less on the degree of debt a person might be in, and more on their ability and commitment to make regular payments;
- in determining whether or not to issue a certificate, took into account how the information had come to light, with individuals encouraged to discuss risks and issues proactively;
- emphasised the role of the individual in taking ownership of remediating the financial issue and keeping to any agreed plan;
- emphasised the need to maintain confidentiality for the individual concerned; and
- where relevant and appropriate, increased the frequency of screening of these individuals.

Firms discussed a range of potential approaches to issuing a certificate in these circumstances, including:

- not issuing a certificate until the individual was actually free from any financial soundness concerns (perhaps changing their role so as to take them out of the Certification Regime);
- issuing a certificate for a role with more controls, or for a shorter time than a year, in order to manage the issue; or
- trusting the individual to manage their own situation, while continuing to carry out routine screening checks.

In larger firms, where an individual cannot be issued a certificate because they cannot demonstrate F&P, firms may be able more easily to move the individual in to a different role while the specific issue is remediated. Smaller firms may have less capacity to do this and may therefore find that they have fewer available options to remediate issues.

It is the firm's responsibility to decide how it should most appropriately implement the SMCR, given its resources, risk tolerances and any other practical considerations. At the same time, and given that this responsibility sits solely with firms, this may result in considerable variation across the sector in terms of actual practices.

A more prescriptive regulatory regime is unlikely to be effective in achieving greater consistency, as many of the decisions that firms are required to make are judgement-based. More detailed rules could also encourage a ‘tick box’ approach to compliance, and make it less likely that firms take ownership of the spirit and overall objectives of the regime. Work by firms themselves collectively to implement aspects of the Certification Regime in a particular way can, however – as the BSB and its member firms have demonstrated in the context of the banking sector – encourage the consistency required to achieve the benefits of the new regime for both employees and customers, while ensuring that responsibility for behaviour, competence and culture remains with and is owned by the firm itself.