

The Certification Regime



Prepared by Worksmart for the benefit of IA members

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The Certification Regime



A good place to start is to understand that the newly introduced Certification Regime for solo-regulated firms is a legislative requirement. This is underpinned by the FCA's SYSC Rulebook with Chapters 23-27 providing the rules and guidance under which firms are expected to operate these internal regimes.

Typically, a firm's Certification Regime will apply to staff who do not hold Senior Management Functions, but whose jobs mean that they could have a significant impact on the firm's customers, markets or the firm itself. These are sometimes referred to as Significant Harm Functions (SHF). However, it is worth noting that the FCA have pointed out that it would be possible for a Senior Manager to hold an SMF, and also be classified as fulfilling a Certified Function. They have however noted that they feel this might be uncommon, so it is worth firms challenging themselves over whether this occurs at all within their firm.

The purpose of introducing this regime (which is owned by the firm and not the regulator) is to ensure that there is appropriate oversight and control over staff who perform one or more of the pre-defined SHF.

The FCA's list of Significant Harm Functions is as follows:

Significant management function
Proprietary traders
CASS oversight function
Functions that are subject to qualification requirements
Client dealing function
Algorithmic traders
Material risk takers
Anyone who supervises or manages anyone performing one of the functions above

Firms need to be very clear that individuals who are identified as being within the Certification Regime are not approved by the regulator. Instead, the FCA has placed the onus on firms to certify that these individuals are fit for purpose in respect of the role that they fulfil for the firm. Ultimately, this means that each firm will have to develop their own approach and processes in order to manage this.



If someone needs to be “certified” for more than one Significant Harm Function, do they need multiple certificates?



This is your choice. Within the rules, you are allowed to provide one certificate to an individual for all of the Significant Harm Functions that they hold, however you must describe in broad terms the area for which the individual has been certified.



Who should own the certification process within a firm?



Experience shows that firms in the banking sector have taken different approaches, and this has been due to size and complexity of the firm. However, there is a consistency in that much of the work around certification cycles will be undertaken by HR teams, even if the ultimate sign off is undertaken either by an SMF or a relevant committee. Bear in mind that someone in your organisation will hold a Prescribed Responsibility for Certification and therefore may well have a view/requirements about how this process is managed.

Getting started

Consider what your firm's policy will be in respect of how you will identify, manage and evidence those in scope. Many firms will, through their project implementation teams, spend a lot of time identifying those individuals that they believe are caught by the regulatory definitions. As certification is a matter for the firm, and there is no regulatory requirement to provide information on the regime to the regulator, it may be some time in the future before this internal regime either becomes subject to any regulatory scrutiny or becomes the subject of an Internal Audit review.

It is therefore good practice for firms and their project teams to ensure that any decisions reached in terms of "who is in and who is out" and the rationale and logic applied to these decisions is recorded securely.



What does a firm's Certification Process look like?

The experience of the banks is that each firm's process will look slightly different to the others. Typically, it is because as a firm builds up their approach to Certification, it will be taking into account their current approaches, methodology and systemisation of a variety of items that support competence in general within their organisation. This will be aligned to the markets they serve, the regulatory rules that apply to their business model and their approach to both the inputs of competence and the measurement of it.

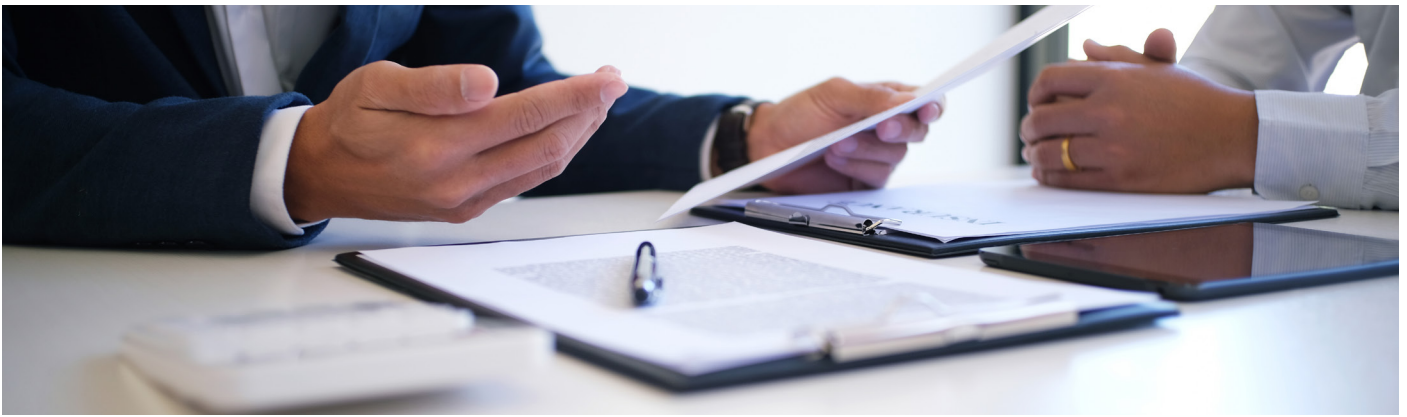
Q Once someone has been "certified" how long will this last for?

A You can certify an individual for a range of time periods. The maximum is 365 days, however there is no minimum, so should you wish to tie in Certification for new starters with their probation period then this is possible.

Q Do all Certification Regime approvals need to be signed off by the responsible Senior Manager?

A No, the Senior Manager who has the Prescribed Responsibility for the Certification Regime is the accountable individual, but this does not mean that they physically have to sign off on every individual. It was our experience in the banking sector that who was responsible for sign off was determined by the size of the organisation and their processes.





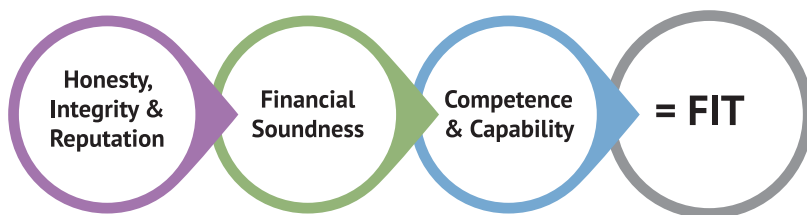
Fitness & Propriety (F&P)

This wide-ranging term has been used interchangeably in both regulatory and commentator publications on SM&CR. It appears to mean different things to different people, but in an attempt to clarify, let's take a walk-through what F&P means to the FCA and also what it means in terms of practical application within a firm.

F&P is covered in the FCA's rule book more commonly known as FIT. The purpose of FIT is to outline to firms and individuals the regulatory expectations. Whom FIT applies to and how a firm might undertake assessments to evidence whether an individual is indeed FIT in relation to the role that they undertake or wish to undertake.

Firms and individuals often make the mistake that FIT is around evidencing someone's financial soundness when in fact that is only part of the picture. As many firms already have to meet regulatory requirements around F&P for their CF30's under the current Approved Persons Regime, then, it is likely that much of this will be familiar to you.

There are 3 elements to FIT, against which a firm must assess an individual to whom it applies, these are as follows:-



The challenge for firms in relation to Certification is to identify the component parts that make up the assessment elements that will trigger either a positive or negative assessment.

Q

We outsource our F & P processing, does SM&CR stop this happening?

A

A firm has the choice as to which of its functions and/or processes it outsources, but remember that outsourcing the requirement means that the firm retains responsibility and accountability for effective completion of outsourced tasks.

The challenge for firms in relation to Certification is to identify the component parts that make up the assessment elements that will trigger either a positive or negative assessment.



In order to assess honesty, integrity and reputation, is it now a requirement to undertake a formal disclosure barring search (DBS)?



No, but if an issue subsequently arises and this would have been captured under a DBS this would bring into question the robustness of the process and could expose the person responsible for the Certification Regime as not taking reasonable steps to discharge their responsibilities. The FCA have publicly stated that firms MAY wish to undertake DBS searches for Certified Functions (where they are legally allowed to do so).

Honesty, Integrity and Reputation

Honesty and integrity are demonstrated by a person who consistently speaks and acts truthfully and fairly in their dealings with others. Reputation is an assessment of how an individual's behaviour has affected the impressions or opinions of others that may reflect positively or negatively on the firm and on the individual's ability to perform their role effectively. FIT 2.1 clearly outlines the requirements in this area, and requires the firm to assess whether an individual has a reputation that will not have an adverse impact on the firm and has not been:

- **Convicted of, or investigated for, any criminal offence**
- **Subject to civil proceedings**
- **Subject to any investigations or disciplinary proceedings by an appropriate regulator**
- **Found contravening any requirements or standards of a regulatory authority, being untruthful or un-co-operative with the regulatory bodies**
- **The subject of any justified complaint relating to regulated activities**
- **The subject of any adverse findings or outcomes relating to directorships or business activities**

At first glance, it would be easy to assume that Conduct Rule 1 'you must act with honesty and integrity' is the only Conduct Rule that dovetails into this section of F&P. But taking the above list into account, it is clear that all of the individual Conduct Rules could apply here, particularly Conduct Rule 3 'you must be open and co-operative with the regulatory bodies'.

Many organisations question the extent to which any of the above can be contravened before they must decide that an individual does not meet the standards required. This is a difficult area because it is for the firm to set their risk tolerance and appetite in this respect. We are aware that as a result of introducing SM&CR into the banking sector, many organisations tightened their approach to what was and what was not acceptable behaviour in light of the newly implemented regime. Firms in the Investment Management sector may well do the same.

But what does that mean in reality and in the context of certification and how are you going to evidence it? The following table provides a flavour of what could be considered, but is by no means an exhaustive or prescriptive list.

A question for the firm to ask itself is 'when was the last time this was verified?' or 'how often are we going to test this?' It is the evidence that counts, not the intention.

	NEW ROLE ASSESSMENT	ANNUAL ASSESSMENT	IN YEAR (MID) ASSESSMENT	EXAMPLE EVIDENCE
Regulatory Reference	✓			<ul style="list-style-type: none"> Acted honestly/ dishonestly in previous role Brought the reputation of themselves/the firm/the industry into disrepute Enhanced the reputation of themselves/the firm/the industry
Pre-employment checks	✓			<ul style="list-style-type: none"> Character references Professional references
Performance Appraisal		✓	✓	<ul style="list-style-type: none"> Recorded observation of behaviour Membership/activity of Professional Bodies 360-degree feedback Annual performance rating Client feedback (positive and negative) Social media profile
Disciplinary procedure or self-declaration		✓	✓	<ul style="list-style-type: none"> Failure to manage conflicts of interest Conduct rule breaches Notification of criminal conviction or caution Output from a regulatory or Professional Body Failure to disclose relevant information to F&P Breach of the firm's policies, e.g. expenses policy
Updated regulatory reference		✓	✓	<ul style="list-style-type: none"> Behaviour resulting in malus or clawback Evidence of a previous conduct rule breach
DBS checks (or equivalent)	✓	✓	✓	<ul style="list-style-type: none"> Any adverse data <p>NB: Please note however that DBS checks (or equivalent) are not a regulatory requirement of the Certification Regime. However a firm may choose to undertake them where they are legally allowed to do so.</p>



Financial Soundness

Financial soundness is demonstrated by an individual who behaves in a financially responsible way and whose financial circumstances do not pose the risk of compromising their professional or ethical conduct. FIT 2.3 outlines this requirement and can be summarised as an assessment to establish whether a person has:

- **Been the subject of any judgement, debt or award that remains outstanding or was not satisfied within a reasonable period**
- **Made any arrangements with creditors, filed for bankruptcy, had a bankruptcy petition served on them, been adjudged bankrupt, been the subject of a bankruptcy restriction order, offered bankruptcy restrictions, had assets seized or been involved in any proceedings relating to the above**

The FCA do not require a statement of assets and liabilities to be produced. However, an assessment of financial soundness should take into account how much financial strain an individual may be under, which in turn can lead to inappropriate behaviour particularly where financial rewards are linked to performance.

From an evidentiary point of view, a credit search satisfies the headline requirements. It is a given that this is undertaken on initial recruitment but under the Certification Regime the requirement is now to confirm F&P on an annual basis. Whilst self-certification might have been the usual course of action to satisfy this area in the past the onus is now on the firm to take responsibility for confirming F&P.



Experience gained from the initial implementation of SM&CR across the banking industry has identified a few different approaches, for example:

- **For the initial certification process, full credit checks on all concerned, with this being repeated every two to three years, and sample checking in the interim period**
- **Full checks on implementation and annually thereafter**
- **Sample checking on implementation, with a programme in place to ensure all certified staff have a full check completed within a three-year period**

Most firms still continue with an annual self-declaration as well, as this provides additional evidence towards certification. This approach also allows the firm to invite the individual to confirm their own position in this respect. Any misrepresentation may well involve a Conduct Rules breach and so by putting the onus on the individual, firms may be more confident that employees will respond truthfully.

There are other triggers of course, such as a breach of expenses policy, indicators of financial irresponsibility or fraud. The challenge here will be to make sure such events are captured, recorded and acted upon in the context of F&P and certification, not just seen as a breach of internal policies.

Another area to consider are the costs involved – depending on the volume and the depth of the checks undertaken, the outlay can be onerous. However, this needs to be balanced against the consequences of not verifying a self-declaration, as this may prove to have far greater ramifications in the longer term.

One of the difficulties of developing a firm’s in-house F&P assessment is understanding what competence and capability is in the context of the Significant Harm Functions that apply to the firm and how this can be evidenced.

Some final questions to consider:

- **Does the firm have the relevant permission from the employee to conduct the searches required?**
- **How and where are records going to be stored?**
- **Who is responsible for deciding when and what checks are to be undertaken?**
- **How is this process going to be linked to the certification process?**



Q

Currently our CF10a is responsible for CASS compliance and is also a Director of the firm. Under SM&CR, they will therefore be an SMF. As there is no CF10a equivalent under SM&CR, how will this work?

A

Generally, a Senior Manager must be responsible and accountable for all elements of CASS compliance under the CASS PR. You should allocate this PR to the Senior Manager who is the most senior person responsible for this area. Once the PR has been allocated, it might be the case that this Senior Manager also performs the CASS Oversight Function, which is a Certification Function. In this situation, the person will be a Senior Manager, and there is no need for the firm to also apply the Certification Function to them. However, as the CASS Oversight Function is often operationally focused, the person performing it might not always, in practice, be a Senior Manager. In this case, the person with the CASS Oversight Function will fall under the Certification Regime. In this instance they won't need to be approved by the FCA but must be certified by the firm.



Under the Certification Regime is there now a requirement to have a full training and competence (T&C) scheme in place?



No, unless those certified individuals are also captured under the requirements to be under a full T&C scheme. However, in order to evidence and assess competence as part of the F&P process, there should be clear documentation and processes in place which support what elements will make up the competence assessment and what will be expected of individuals in this respect.

Competence and Capability

Whilst the regulator provides a high-level steer on what is required, there is no specific detail as to what this should encompass. According to FIT 2.2, in determining a person's competence and capability, there must be due regard as to whether the person:

- **Has demonstrated by experience and training that they are suitable to perform the function, and**
- **Adequate time to perform the function and meet the responsibilities associated with the function.**

For those firms that are in addition subject to the TC rulebook, there is an additional element to consider which is:-

- **In determining a person's competence and capability, there must be due regards as to whether the person satisfies the relevant FCA Training & Competence requirements in relation to the function being performed.**

To put that in plain English, competence and capability can be described as:

- **The professional experience and qualifications that an individual brings to a role, and**
- **Performance of the individual in their role, developing and maintaining their level of knowledge and skills over time.**



There are two strands to this. Firstly, qualifications and experience, which is historic and factual, and secondly, the far more subjective topic of how well that person performs within their role. In order to establish and evidence the latter there needs to be a clearly defined set of actions, activities and outputs which can be measured against agreed benchmarks. Only by having this in place can an assessment of competence be made, which in turn will provide confidence in the validity of the certification process.

Each firm should have their own definition of competence for each role performed within the organisation. Each role should have a clearly defined job description that details the competences, experience and qualifications (where required) for the role. The job description should be used through the recruitment and induction process to align skills and competencies to role requirements.

In light of the legislative requirement to implement a Certification Regime within firms, a review and updating of job descriptions is likely to be a requirement for all firms. This was evidenced by the experience of those organisations who are already under SM&CR, the majority of whom had to either review and/or create job descriptions for all roles captured as part of their preparation and implementation activities for SM&CR.

The range of activities used to support and evidence competence are wide and varied depending on firm type and what evidence indicators they have chosen to adopt. But it is worth considering that competence is not just how good the score was at an annual appraisal. Performance against a target (or a range of targets – financial/non-financial) is a reflection of how successful that person has been in terms of numbers or output, but there will always be other indicators of competence, which is how the person achieved this success – in other words, the behaviour that supports the results.

Below is a range of activities and evidence that could be used to build an overall picture of competence, both initial and ongoing. Again, this is not exhaustive or prescriptive.

e-learning	1:1 meetings	Annual assessments	Peer reviews
Performance/attendance on training courses	Client interaction monitoring/observations	File reviews or transaction audits	Interaction/input at team meetings
Complaints	Trading figures	Performance reviews	Mandatory CPD
Mentoring colleagues	Coaching colleagues	360 feedback	Self-declarations
Qualifications	Development plans	Professional body evidence	Voluntary CPD

It is worth noting that Continuous Professional Development as an activity is a critical component in evidencing, maintaining and developing competence. Many individuals within a firm may belong to a Professional Body and be required to complete CPD as part of that membership, however many will not, so it is for firms to decide what their approach to CPD is and how this will be managed across an organisation.

Individuals within firms that work hard to manage and develop their competence and capability will be at the same time evidencing their adherence to the Conduct Rules, most specifically Conduct Rule 2 which is all about acting with due skill, care and diligence.



Do I really need to review all our contracts of employment for individuals?



A firm will need to decide whether the changes that are brought about by implementing SM&CR require employment contracts to be reviewed. There are implications in respect of individuals that fail to become certified, and individuals that go on to breach the new conduct rules. It is likely that this would be part of your project implementation preparation.



Regulatory Referencing

As part of the changing regime and the focus on personal accountability, the requirement for the provision of regulatory references was updated and these form part of the foundation for an initial assessment of F&P at the recruitment stage. The detail is fully covered in SYSC 22 but some headline points to note from a practical point of view are:

- **Regulatory references are required for those performing a certified role**
- **The rules apply irrespective of the individual's employment status**
- **Regulatory references need to be obtained before certification**
- **Firms need to take reasonable steps to obtain references from overseas firms**
- **The current employer and any employer in the past six years are required to provide a regulatory reference and FCA guidance suggests that firms should provide them within six weeks of the request**
- **This applies to all employers, not just authorised firms**
- **References do not need to be provided intra-group if records are kept centrally**

NB – Where an individual has previously worked in a non-regulated firm, there will be areas of the FCA's regulatory references template that will not be applicable to them, however a firm should not discount sending a regulatory reference just because an individual worked at a non-regulated entity.



Q *What format do I use to undertake a Regulatory Reference?*

A The FCA's regulatory reference template can be found in SYSC 22 Annex 1.

Q *A candidate for a certified role has previously worked abroad. What actions can be taken if a regulatory reference cannot be obtained?*

A There is a requirement to demonstrate that reasonable steps have been taken to obtain the relevant reference. The evidence to support this would include copies of the documentation issued, follow up and final requests. Ultimately, if a reference cannot be obtained other evidence to support the period of working abroad could be used as a substitute, as long as evidence can be provided of the attempts made to obtain the original reference.



What's required?

Regulatory references must disclose all information which is relevant to the assessment of F&P, including:

- **Whether the individual has performed any of the certification roles**
- **Whether they have breached any conduct rules or required levels of F&P**
- **Whether any disciplinary action has been brought against them, which is defined as:**
 - *A formal written warning*
 - *Suspension or dismissal*
 - *Reduction or recovery of remuneration as a consequence of a conduct breach*

SYSC 22 Annex 1 (Template for regulatory references given by SM&CR firms and disclosure requirements) provides the mandatory template that must be used when issuing regulatory references and firms need to actively confirm whether there is any other information that they would reasonably consider to be relevant. An example of this would be serious misconduct which occurred more than six years ago and further guidance in this area is covered in SYSC 22.5.11.

One consequence of the updated rules is that if a firm becomes aware of an issue that would have changed a reference provided within the preceding six-year period then there is an obligation to update the reference. This will only be to the employer who was provided with the reference, whether or not the employee still works there. As intended by the rules, the opportunity for individuals to 'job hop' to avoid problems catching up with them has gone.

Q

The firm is expected to confirm whether there is any other information considered relevant within a regulatory reference. What should this include?

A

The FCA has declined to provide specific guidance in this area, but suggests referring to the FCA handbook and making decisions on a case by case basis. Information that has not been verified is not required to be disclosed.



Some practical issues

- There needs to be a balance between regulatory duties and common law duties requiring due skill and care in the preparation of the reference, particularly given the serious career consequences of any negative information disclosed.
- Difficult judgements may need to be made in some cases. For example where disciplinary action is not the outcome, but the individual has been implicated, or where an issue has come to light after the person has left the firm, but has not been able to provide any commentary. Indeed, it would be unfair to prevent input from the 'accused' and consideration should be given to this potential future issue.
- Termination and settlement agreements may be in conflict with the regulatory referencing requirements and relevant employment contracts, policies and procedures may need to be reviewed and updated.
- Key departments in the business, such as HR, Compliance and IT may find it useful to adopt a policy on regulatory references, ensuring a co-ordinated and consistent approach.

The Banking Standards Board have recently issued a consultation paper and draft guidance which aims to assist firms navigating the process around regulatory referencing.

A final note on this subject is to confirm that it is the hiring firm's ultimate decision as to how the information supplied on the regulatory reference is used and to what extent it influences the decision to hire or not.



Q

What should a Certificate look like, the FCA rules do not define how we should approach this?

A

The FCA provides a small amount of guidance on this via SYSC 27.2.9 (G) and notes that a certificate issued by a firm to a person must:

1. state that the firm is satisfied that the person is fit and proper to perform the function to which the certificate relates; and
2. set out the aspects of the affairs of the firm in which the person will be involved in performing the function.





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