THE INVESTMENT ASSOCIATION

IA Response to HMT Call for Evidence on Senior Managers and Certification Regime

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 46% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA welcomes the opportunity to respond to HMT's Call for Evidence on Senior Managers and Certification Regime (SM&CR). In addition to responding to the HMT Call for Evidence, the IA is also responding to the FCA/PRA joint Discussion Paper (DP 1/23) released in parallel on this topic. Where relevant we have made references to details of our response to DP1/23 in this response.

We recognise the role of SM&CR in promoting accountability and reinforcing strong governance within the financial services industry and welcome this review as a timely opportunity to assess the regime's effectiveness.

SM&CR is a valuable tool for establishing strong governance, and competence in regulated firms. However, its expanding scope, prescriptive requirements and process inefficiencies, have resulted in increasing complexity and cost of compliance. This is often significantly disproportionate to the anticipated benefits or behavioural changes that these requirements seek to achieve. With the Financial Services and Markets Bill 2022 introducing the secondary objective of competitiveness for the UK regulators, it is ever more important to take steps to critically review and improve the UK's SM&CR regime to make it fit for purpose and effective against its objectives.

The Investment Association

Camomile Court, 23 Camomile Street, London, EC3A 7LL
www.theia.org

[Team or your Email Address]

@InvAssoc @The Investment Association

We therefore welcome the HMT, FCA and PRA's[1] openness for feedback to address areas where the regime may not be working effectively in practice. This approach will enable the industry to continue to move in the right direction and ensure that firms maintain the highest standards of conduct and culture.

Summary of the key views in this response:

There is widespread consensus supporting the objectives of the regime and its usefulness as a tool to reinforce strong governance, accountability, and culture within firms. There is, however, a strong sentiment that over the years, the regime has become rigid, either due to the prescriptive requirements or often due to its implementation, eroding the flexibility for firms to be able to manage their conduct and culture in line with their risk profiles.

The implementation of SM&CR and its expanding scope are making compliance increasingly costly and disproportionate. It is also seen as a barrier to attracting senior level talent to the UK. More generally, the UK's regulatory landscape is seen as complex and harder to navigate due to constant changes and regulatory creep, which amplifies the scope of SM&CR. To maintain competitiveness, it is crucial for the regulators to engage in meaningful consultation and collaboration with the industry removing unnecessary administrative burden for firms as well as the regulators to deliver a regime that is robust, impactful and easy to comply with.

With overall support for an accountability regime, we do not advocate for its removal. Our focus is on the greatest potential for improvement which focusses on revamping the operational aspects of the regime and its implementation.

We have outlined some suggestions for improvements to the regime below which centre around the benefits of transparency and information sharing from the regulators, that can help enhance the UK's attractiveness by reducing the cost of doing business and providing more certainty, particularly for those in Senior Manager Functions (SMFs). Many of our asks are operational improvements and do not require changes to the primary legislation, and as such should be relatively simple to implement:

- **Clarity on the purpose of the regime.** There is a noticeable lack of interoperability between SM&CR and other regulatory initiatives leading to conflicts with their respective objectives or administration and inconsistencies in application. The introduction of newer regulations such as the Consumer Duty, sustainability measures or algorithmic trading which are tied to SM&CR has contributed to an expanding list of accountabilities which firms are required to allocate to individuals within the regime. This is further complicated by the fact that many of these considerations arrive through a varied range of channels such as Firm Evaluation Letters and Dear CEO letters. It is crucial for regulators to reaffirm that the regime is meant to serve as the overarching regulatory standard that encourages good culture and behaviour as opposed to being perceived simply as a tool in the regulator's toolkit.

- **Thematic review of Conduct Rules Breaches.** Considerable time, efforts and resources have been put into SM&CR implementation across the industry including in analysing and reporting conduct breaches. With the regulators having collected significant data from firms since the regime's launch, there are considerable merits in conducting a comprehensive thematic review of the Conduct Rule Breach process. Publishing insights and themes of such a review, in particular Non-Financial Misconduct,

[1] As most of IA members are regulated primarily by the FCA, our response focusses on the FCA as the primary regulator of SM&CR. To the extent the areas identified also apply to the PRA, we would urge consistency of approach across regulators.

would greatly benefit the industry in determining appropriate thresholds and improving transparency will help firms understand how information they report is utilised by the regulators and help them review their conduct breach processes to make sure they remain appropriate and robust and minimise the significant disparity in the level of or severity of breaches reported back to the regulator. It would also be useful to understand the purpose of line-by-line reporting with regards to conduct rule breaches.

- **Risk-based SMF approval process.** In approving SMFs, we recommend a more risk-based approach that takes into account, to a higher degree, an individual's experience in similar SMF roles, whether in the same firm or different firms, in the UK or in similar positions abroad. This should include recognition of suitable international accountability regimes that are comparable to the UK regime, allowing an easier transition of personnel without requiring a full-scale and lengthy approval process.

  This can be achieved through undertaking the following steps:
  - Carry out a review to recognise compatible international accountability regimes allowing SMFs to move from specified jurisdictions into a similar role in the UK.
  - To deal with continuing delays in authorisations, we recommend introduction of a Notified Person requirement and triaging in certain specified circumstances or SMFs, where only notification from the firms to the regulator is required (similar to the notification procedures for changes to the management body for non-SMF directors), rather than needing to receive full regulatory pre-approval for pre-existing or existing SMFs that have experience in similar firms or have been promoted within a firm. This should extend to existing SMFs when moving roles in the same firm or from another UK firm.

- **Use of technology to significantly improve and enhance the operational experience and effectiveness**. The FCA's recent commitment to strengthening its capability and capacity through investment in people, technology and data in its Business Plan, can be the perfect catalyst for upgrading and digitising the processes associated with SM&CR. This should include the burdensome Connect system and the FCA Financial Services Register, reducing the approval times, allowing efficient filtering and triaging and thereby significantly improving the administration of the regime. In addition, we strongly encourage the regulator to use mechanisms under AI and update their technology to allow firms to link their systems to the register. This would drive better outcomes, retain and use information as part of assessments as well as reduce manual processing for firms with regards to new SMF applications or the addition and removal of existing SMFs. This could help significantly reduce SMF approval times and help the regulators focus on areas and individuals it deems risky.

- **Review of Annual Certification requirements.** To address the disproportionate and costly regulatory requirements associated with the Annual Certification Regime, considering that misconduct is often detected through other systems and controls like onboarding and annual performance reviews. We strongly recommend that HMT re-evaluates the rigidity of these requirements which are contained within primary legislation requiring any changes to be made through parliamentary approvals. In the first instance, moving the certification requirements from primary legislation to the FCA Handbook, will allow the FCA to effectively consider the appropriateness of these requirements and set out less prescriptive and more flexible certification requirements for firms to apply based on their size and risk profile of the firm. For instance, the FCA could allow re-certification up to every 3 years instead of annually, unless there have been any significant changes in an individual's circumstances, while allowing the flexibility for firms to continue with annual or other frequency certifications that align with their processes.

- **Remuneration deferral requirements.** We propose a further review of the 7-year deferral requirement which substantially impacts Material Risk Takers (MRTs) and PRA designated SMFs, for applicable investment firms. Where this or other deferral requirements differ internationally, we propose

implementing consistency e.g., matching the EU deferral requirement of 5 years. Reducing the 7-year deferral will also allow firms to make best use of the proposed removal of the bonus cap, as staff will be resistant to increasing variable remuneration if deferrals remain substantially above those in other jurisdictions, this could ultimately lead to detracting talent from coming to the UK.

- **Scope and review of thresholds.** The threshold of £50bn for enhanced firms has remained static since its introduction without factoring in inflation. We propose that the limit is reviewed to take into account AUM increase due to inflation.

  Additionally, to provide firms with a smoother transition when moving from one category to another such as from core to enhanced, we recommend allowing them sufficient time to gradually increase their SMFs. This approach recognises the practical challenges faced by firms in adjusting their senior management structure and responsibilities. By allowing a more gradual increase in SMFs, firms can effectively plan and implement necessary changes while ensuring continuity in their operations.

  This would alleviate the burden of a sudden and significant organisational overhaul, reducing operational disruption and potential risks associated with swift decision-making. Firms would have the opportunity to assess and allocate SMF functions in a deliberate manner, ensuring appropriate alignment with their specific business needs and regulatory requirements.

Q1: Has the SM&CR effectively delivered against its core objectives? For example, making it easier to hold individuals to account; or improving governance, behaviour and culture within firms.

Feedback from members indicates that the objectives of SM&CR particularly in reinforcing personal accountability and improving governance have generally been met. The SM&CR regime, and the Approved Person Regime before then, have sharpened the focus on senior manager responsibilities in UK. This has supported investment management firms in maintaining strong conduct and culture. This has also notably heightened the measures for accountability of senior managers which we generally view to have a positive effect on the conduct and culture of firms. Whilst it is critical that accountability is championed in the industry, there is a delicate balance to be struck so that neither regulators nor firms are overburdened by it. SM&CR should not create bureaucracy, nor disincentivise good individuals from holding relevant positions and responsibilities. Current member feedback suggest that the regime would benefit from being refined.

We urge the regulators to review their experiences with the regime and publish their assessment of its effectiveness in achieving its stated objectives. By sharing their findings, the regulators can provide valuable insights into the impact and outcomes of the regime. Publishing this assessment will enhance transparency and accountability in the regulatory process. It will allow stakeholders, including firms and industry participants, to gain a better understanding of the regulators' perspective and provide an opportunity for constructive feedback and dialogue. This will help refine and enhance the regime, ensuring its continued relevance and effectiveness in meeting its objectives whilst committing to continuous improvement and collaboration with the industry, fostering a regulatory environment that is responsive, transparent, and conducive to achieving the desired outcomes of the regime.

Q2: Do these core objectives remain the right aims for the UK?

The core objectives of the regime continue to hold relevance for the UK. If the regime is critically reviewed and improved so that it is more proportionate to the core objectives, it will contribute to positioning the UK as an attractive destination for businesses that prioritises strong governance and accountability.

An improved regime will not only benefit businesses but also contribute to a more robust and efficient financial sector. It will instil confidence among investors, stakeholders and clients, reinforcing the UK's reputation as a global hub for businesses that prioritises strong governance practices.

Q3: Has the regime remained true to its original objectives or has the scope or use of the regime shifted over time?

Over time, the scope of the SM&CR regime has expanded, and it now applies to wider range of financial services firms. For smaller investment management firms, in particular, this has resulted in disproportionate regulatory requirements. Specifically, the significant increase in the number of required SMFs when a firm reaches the financial threshold of £50bn Assets Under Management (AUM) seems disproportionate in most instances. To make the regime more proportionate, we recommend a gradual transition from Core to Enhanced. This would ensure that the regulatory burden is commensurate with a firm's size and complexity, without compromising the overall effectiveness of the regime. In addition to this, the threshold of £50bn has remained static without factoring in inflation, this should be reviewed and increased. Please refer to our response to Q5.

Q4: The government would be interested in respondents' reflections on their experience of the SM&CR, now that it has been in place for some years?

Q5. What impact does the SM&CR have on the UK's international competitiveness? Are there options for reform that could improve the UK's competitiveness?

This response relates to both Q4 and 5. The notion of holding accountable individuals who possess significant influence over decision making at firms is a fundamentally valid concept and one supported by the industry. While the UK's financial services eco-system is recognised for is robust regulatory landscape, it is important to strike the right balance between effectiveness and proportionality as the UK is increasingly being viewed as having an overly burdensome regulatory environment.

There is a noticeable lack of interoperability between SM&CR and other regulatory initiatives leading to conflicts with their respective objectives or administration. The introduction of newer regulations such as the Consumer Duty, sustainability measures or algorithmic trading which are tied to SM&CR has contributed to an expanding list of accountabilities within the regime. This is further complicated by that fact that many of these considerations arrive through a varied range of channels such as Firm Evaluation Letters and Dear CEO letters.

We acknowledge the recent improvement in the FCA's Service Level Agreement (SLA) metrics on SM&CR applications but consider the 90-day SLA target still too long. The framework of the regime however continues to bring a heavy administrative toll on firms. The long lead times for approvals renders even simple changes a resource intensive exercise. Moreover, the regime contains obligations and processes that makes compliance significantly onerous, brings about uncertainty and disproportionality. They are all important blockers that fuel the perception of the regime being 'inflexible' and 'bureaucratic'. Examples include:

1. **Lack of an efficient and consistent approach for onboarding existing SMFs.** Overwhelming feedback from our members indicates that the detailed and time-consuming requirements for personnel transitioning into similar SMF roles, acts as a significant barrier and commercial deterrent when hiring senior personnel in the UK This is whether the transfer is internally in a firm, to another UK firm or from an international location with compatible accountability requirements. The delays in obtaining approvals and the lack of a consistent approach to the approval process creates real commercial and

practical difficulties for firms when publicly announcing new senior-level hires. Many will await approvals, due to the risk of public embarrassment for the firms and individuals if the approval is denied, even for a technical reason.
Furthermore, difficulties arise from the inherent notion that firms are required to demonstrate that individuals carrying out SMF roles elsewhere are not guilty of poor conduct or misconduct in their previous positions. Proving a negative is inherently challenging, and a more nuanced approach is needed. Detailed assessments should only be necessary if the regulators have reasonable grounds to believe that an individual should not continue to be appointed as an SMF. This distinction, which is commonly observed in broader legal contexts, should also be extended to this regulation.

In summary, there is a pressing need to streamline the onboarding process for existing SMFs. Addressing the challenges associated with approvals, providing consistency, and adopting a more balanced approach to assessments would greatly enhance the efficiency and attractiveness of hiring senior personnel in the UK. Ensuring a smoother transition while maintaining the necessary regulatory oversight.

Our recommendations:

- Carry out a review to recognise compatible international accountability regimes allowing SMFs to move from specified jurisdictions into similar roles in the UK.
- Allow easier onboarding of existing SMFs when moving roles either in the same firm or another UK firm, recognising the existing assessment of current SMFs.
- To deal with continuing delays in authorisations and associated issues, we recommend introduction of a Notified Person requirement in certain specified circumstances or SMFs. Where only *notification* from the firm to the regulator is required (similar to the notification procedures for changes to the management body for non-SMF directors), rather than needing to receive full regulatory pre-approval for pre-existing or existing SMFs that have experience in similar firms or have been promoted within a firm.

2. **Purpose of the regime and interaction with other regulatory requirements.** The scope of SM&CR has undergone constant expansion over the years, leaving industry participants uncertain about its intended purpose. The frequent inclusion of SM&CR in discussion papers on new regulatory initiatives such as consumer duty, sustainability, as well as in Dear CEO letters without clear outcomes creates an unfair perception that the regime is all-encompassing and causing delays in various areas.

   Additionally, questions also arise regarding how the FCA utilises the data collected as part of Conduct Rule Breaches, what insights it provides, and what lessons the industry can learn from the reported breaches, in particular Non-Financial Misconduct.

   Therefore, it is imperative to address the expanding scope of SM&CR and the need for transparency in the Conduct Rule Breach process.
   Our recommendations:

- It is crucial for regulators to reaffirm that the regime is meant to serve as the overarching regulatory standard that drives good culture and behaviours as opposed to simply being used as a tool in the regulator's toolkit.
- In addition, conducting a comprehensive thematic review of the Conduct Rule Breach process would greatly benefit the industry. Determining appropriate thresholds and improving transparency are essential aspects of this review. By providing learnings and sharing thematic insight on certain parts of the regime. Providing transparency in the analysis and utilisation of breach data to outline themes, trends and lesson learnt, the industry would better understand these rules and areas of focus, in particular, Non-Financial Misconduct.

3. **Onerous administrative requirements:**

- **The core rule's Annual Certification requirements.** Annual Certification is currently a significant cost for firms with disproportionate outcomes, as any misconduct identified is often detected through other systems and controls rather than the Annual Certification Process. For most firms, individual misconduct cases are captured and addressed as part of the firm's existing hiring and employee onboarding processes as well as through annual performance reviews, outside of the SM&CR Annual Certification requirements. This brings to question the effectiveness and benefit of the Annual Certification requirement.

  Our recommendations:
  We strongly recommend that HMT re-evaluates the rigidity of these requirements which are contained within primary legislation, requiring any changes to be made through parliamentary approvals. In the first instance, moving the certification requirements from primary legislation to the FCA Handbook, will allow the FCA to effectively consider appropriateness of these requirements and then set out less prescriptive and more flexible certification requirements for firms to apply based on their size and risk profile. For instance, the FCA could allow re-certification up to every 3 years instead of annually, unless there have been any significant changes in an individual's circumstances, while allowing the flexibility for firm to continue with annual or other frequent certifications that align with their processes.

- **FCA's 30-day rule.** The 30-day rule, which recognises the international nature of the UK financial services industry and provides an exemption from SM&CR certification for short-term visitors, is welcomed in principle. However, in practice, the 30-day limit is relatively short, leading firms to certify individuals ahead of time to meet onboarding requirements, making it less generous in practice. Additionally, the limit can be easily breached by individuals taking multiple short trips within a 12-month period.
  Our recommendations:

  To address this, we propose extending the exemption to 90 days to strike a balance between policy intentions and the certification needs of individuals primarily based outside the UK. We commend the FCA for their recognition of the need for sensible short-term visits and encourage similar pragmatic accommodations in other regulatory areas to avoid confusion and unnecessary burdens on firms.

- **FCA's 12-week rule.** The 12-week rule, aimed at addressing the practical challenges of approving temporary senior managers, is welcomed in principle. However, its effectiveness is hindered by the short time-period. It becomes nearly impossible to select and approve a new candidate within the 12-week window, especially in cases of sudden departures or when specialised expertise is required. Additionally, the FCA's approval process often takes the entire 12 weeks, leaving little time for firms to complete the necessary preparations. There are also instances where firms require temporary coverage for a shorter period, yet still need to go through the full SMF process.

  Our recommendations:

  To address these concerns, we propose extending the window to 36 weeks as was done temporarily during the pandemic and streamlining the application process for temporary SMF appointments lasting less than 12 months. This would enable the rule to accommodate its intended scenarios more effectively.

  We have outlined further proposed improvements to remove operational inefficiencies which are within the powers of the FCA and PRA as regulators, in our response to DP 1/23.

Q6. Are there examples of other regimes that the government could learn from?

The accountability regimes of Singapore and Hong Kong are often referred to by members as effective and pragmatic.

Q7. How does the level of detail, sanctions and time devoted to the UK's SM&CR regime compare with that in other significant financial centres?

Although the UK's accountability regime has influenced the development of similar regimes by international regulators, the UK SM&CR regime is seen as more burdensome and bureaucratic compared to similar regimes in competitor markets. Notably, the accountability regimes in Singapore and Hong Kong are frequently referenced in this context.

Q8. Are there specific areas of the SM&CR that respondents have concerns about or which they believe are perceived as a deterrent to firms or individuals locating in the UK? If so, what potential solutions should be considered to address these? Respondents should provide as much detail as possible to help build the fullest picture of any issues.

Anecdotal evidence from our members suggests that SM&CR is a key consideration when senior individuals make decision to move to the UK. The delays associated with the approval process may mean having to wait up to a year to receive their approval. While making significant career and family decisions, this delay can be unsettling and unattractive. While we understand that in some circumstances particular assessments need to be extended, due consideration needs to be given to the individual and any accountability regimes that they may already be subject to, in their home country. We urge HMT and the regulators to further enhance or analyse the comparability of the UK regime to that of international regimes so that instances like this do not deter international talent relocating to the UK.

Another area that directly impacts the attractiveness of the UK is varying degree of remuneration deferrals such as the enforced 7-year deferral requirement for applicable investment firms. The 7-year deferral requirement is inconsistent with international norms, the EU deferral requirement is 5 years. It also reduces the ability of firms to make best use of the proposed removal of the bonus cap, as staff will be resistant to increasing variable remuneration if deferrals remain substantially above those in other jurisdictions and will naturally detract talent from coming to the UK.

Please see responses to Q4 and Q5 for an outline on other deterrents and potential solutions.

Q9. Is the current scope of the SM&CR correct to achieve the aims of the regime? Are there opportunities to remove certain low risk activities or firms from its scope?

With the scope of the regime, having expanded constantly in the recent past, now is a good opportunity for the regulators to take a proportionate risk-based approach. Please see our response to questions 4 and 5 for opportunities for improving the regime for low-risk activities and firms.

Q10. Are there "lessons learned" that government should consider as part of any future decisions on potential changes to the scope of the regime to ensure a smooth rollout to firms or parts of the financial services sector?

Please see our responses to Q4 and Q5. A key lesson is that any regime requires higher degree of flexibility and adaptability at the outset as well as throughout its implementation. We note a number of changes and considerations that could refine the regime to foster greater competitiveness throughout this response.

Q11. Any other comments the government or regulators would benefit from receiving?

We do not any further comments.