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30 May 2023

AFM Response to DP1/23, Review of the SMCR

1. I am writing in response to this discussion paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
 - Comment on the proposals, and
 - Explore the consequences for members of AFM and their customers.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 32 million people in the UK and Ireland, collect annual premium income of over £22 billion, and employ nearly 30,000 staff¹.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses² and to take account of corporate diversity³.

¹ ICMIF and AFM, 2022: <https://financialmutuals.org/wp-content/uploads/2022/10/UK-Market-Insights-2022.pdf>

² Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

³ <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

AFM comments on the proposals

4. We welcome the opportunity to respond to this discussion paper.
5. AFM and its members recognise the importance of the SMCR in preserving clear standards in financial services. We support the broad aims of the regime, and would not welcome wholesale change. We do consider though that there is scope to improve the delivery of some aspects of the SMCR, and have commented on these: in particular, as the paper acknowledges, there have been continued problems in the authorisation process.
6. We have attached the survey as requested, and would welcome the opportunity to discuss further the issues raised by our response. We are happy to be included in the published list of respondents, and no parts of our response should be considered confidential.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'MS' followed by a stylized flourish.

Martin Shaw
Head of Policy
Association of Financial Mutuals

Senior Management and Certification Regime Review 2023

Joint PRA FCA Discussion Paper DP23/03: Senior Management and Certification Regime Review

Chapter 3 - Effectiveness, Scope and Proportionality

Effectiveness

Q1. To what extent do you agree or disagree with the statement that the SM&CR has made it easier to hold individuals to account?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have additional comments, please add below.

The regime removes possible ambiguity for employers, and sets clear expectations for individuals. Whilst the number of actions taken against individuals has been low, the examples set have been powerful.

Q2. To what extent do you agree or disagree with the statement that the SM&CR regime has improved safety and soundness and conduct within firms?

- Strongly agree ☐
- Agree ☒
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have additional comments, please add below.

Our response is only qualified by delays in the authorisations process, as covered later in the survey.

Fitness and Propriety

Q3. To what extent do you agree or disagree that the fitness and propriety requirements support firms in appointing appropriately qualified individuals to Senior Manager roles?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

Q4. Please provide any suggestions that can help ensure that appropriately qualified individuals are not deterred from taking up relevant Senior Manager roles.

We agree that a robust ‘fit and proper’ process provides comfort to firms when on-boarding new individuals, and additionally when assessing existing staff to ensure they remain Fit and Proper in their role.

SMCR has contributed to the ongoing professionalism of Boards. The Certification regime is helpful in ensuring not every NED has to conform to the very high standards expected of SMFs. However, for small mutuals and friendly societies, many of whom previously paid only very limited attendance fees to NEDs, the SMCR has increased costs significantly, and made it more difficult for mutuals to appoint member-Directors, which removes the scope for diversity of experience in some Boards.

Holding individuals to account and incentives

Q5. To what extent do you agree or disagree that the SM&CR has made it easier for firms to hold staff to account and take disciplinary action when appropriate against them?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

The conduct rules make it clear to staff the behavioural expectation that the firm and industry requires. The introduction of the rules has facilitated discussions on conduct across all levels of companies. However, with limited examples from the regulator on what constitutes a breach, we do have difficulty assessing the lessons from upheld

disciplinary cases, especially when taking into account the duty of care we owe to any individuals involved.

Arguably, if internal controls are working well, any upheld disciplinary action should result in improved behaviour and this would be included in a regulatory reference (if within 6 years). Hence the conduct rule breach is surplus to requirements, especially at lower levels. We question therefore whether the annual reporting of breaches to the FCA should be narrowed to the most senior individuals, or be subject to a level of materiality. Firms do not generally receive feedback from the REP008 return and this would be helpful in order to better understand if they are capturing the right issues.

Collective decision-taking

Q6. To what extent do you agree that the specific accountabilities of individual directors established by the Senior Managers Regime work in ways that complement the collective responsibility of the board of directors or decision-making committees?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

Are there ways this could be improved?

In general terms, the approach is right, though tensions can emerge when individuals leave and responsibility are revised as the SMCR is quite rigid in terms of expectations and timescales.

Enforcement

Q7. To what extent do you agree or disagree that the prospect of enforcement promotes individual accountability?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

We agree that the prospect of enforcement does promote individual accountability and acts as a valuable deterrent to poor behaviours. The potential of a significant fine (or other enforcement action) helps demonstrate the importance to an individual so that they fully understand the level and scope of their responsibilities. With the introduction of SMCR there is a greater understanding that poor conduct can have a long term impact on a firm and the industry.

Q8. How could our approach to enforcement be enhanced to better support the aims of the SM&CR?

With many firms not having direct supervision, the quality of pre-enforcement engagement can be inconsistent. This means in some cases enforcement action might be too late or ineffective.

Whilst enforcement can act as a good deterrent to prevent poor behaviours, as mentioned above, there are limited examples from the regulator on what constitutes a breach and it would be helpful to see articulation of what steps regulators go through and/ or more enforcement cases at an individual level. We would also welcome more guidance on

what constitutes a conduct breach, particularly where it relates to an individual’s behaviours.

Scope

Q9. To what extent do you agree or disagree that the scope of the SM&CR is appropriate?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

We agree that in general, SMCR captures the right people. However in some cases the scope of the certification regime extends beyond what is reasonably required. Certification currently captures individuals subject to the Training and Competence Sourcebook where there is a qualification requirement. This includes many front line administration staff and their managers. These individuals are already subject to a robust T&C scheme and there is no benefit in capturing them under certification as well. We consider certification could readily be amended to exclude certain T&C activities so that it was properly focused on the higher risk individuals, for example Financial Advisors.

HR staff who are instrumental in day to day running of the various elements of the SMCR, would not be reported under the conduct rules, even though a material misjudgment could have an indirect customer impact.

Q10. Are there actions the regulators could take in respect of the SM&CR that would help enhance competition or international competitiveness?

We don’t have international members and can’t comment on the impact of the regime on overseas firms/ parents. However, we do consider it is important that rules relating to UK firms do not place those businesses at a competitive disadvantage compared to firms or individuals based outside the UK. We have seen lower standards applied to insurers passporting into the UK, and it is not by chance that the majority of FSCS cases in UK insurance related to overseas providers.

Proportionality

Q11. To what extent do you agree or disagree that the SM&CR is applied proportionately to firms and individuals?

- Strongly agree ☐
- Agree ☒
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you would like to elaborate on your view, please do so.

We consider that often supervisors are overly cautious in applying proportionality principles. For examples, the SMCR recognises the possibility of double-hatting in small firms, particularly where the Executive is small in number. However, AFM members have been actively discouraged from pursuing the need for senior Executives to undertake more than one SMF role. In some cases, this has led to lengthy delays in authorisation, and in others, firms have suffered significantly higher costs from the need for extra recruitment. It would be helpful to have a detailed consideration of the benefits and risks of double-hatting, and for specific evidence of cases where double-hatting has produced bad outcomes.

Chapter 4 - Other improvements to the SMCR

Regulatory approvals

Q12. How could the process for SMF approvals be further improved?

We recognise progress has been made in the recent past in speeding up authorisations, and as the FCA Business Plan testifies, there has been a significant- and long overdue- increase in staff in this area. Whilst the FCA authorisations update from October 2022 was useful in highlighting areas that fall short, we would like to see more transparent performance measures. The published figure for 2021/22 for example was only 85.9% of authorisations responded to within three months, but there was no breakdown between SMCR, CF and SIF applications. We have also seen liberal use of tactics to ‘stop the clock’ in the past, which means that at the last minute questions are raised to buy time for the authorisations team.

One area where there is greater scope for alignment of interests, is for FCA to be more explicit on what constitutes a ‘good’ application. AFM and members went through a similar exercise with PRA in 2021, to identify how firms could improve the chances of a clean review. FCA was unable or unwilling to provide evidence of poor practice in

submitting applications at that time, and we consider this was a missed opportunity for a win-win for firms and regulators.

In addition, we suggest regulators review how to make the process more efficient. For example, FCA might reconsider the approach it takes to candidate interviews: often these focus on a potential director's knowledge, rather than on issues that might be better covered face-to-face, such as values and culture, and which are a better fit with the appropriateness test the regulators are seeking to assess.

Delays can be experienced when one regulator leads the approval, and the other has to then add an extra layer of approval to the application. This leads to the primary assessments being completed at different times and on multiple occasions we have seen the 'clock stopped' for the PRA questions and then again at a later date when the FCA make further enquiries. Additionally, as PRA does not have access to FCA's Connect system, firms may have to re-submit information more than once, adding extra delays. The timescales could be significantly improved by the two regulators coordinating the application, or permitting the one to complete the approval on the other's behalf.

With regard to Regulatory Reference, some AFM members have found that many firms use the six week regulatory timeframe as a guide, and quite often an otherwise complete application is ready to submit pending the final regulatory reference(s), but applications submitted without all references 'stop the clock'. Two possible solutions might be to decrease the regulatory timeframe to four weeks, or to allow firms to submit the application prior to references being received on the understanding that if, in the unlikely event that anything comes to light that impacts the F&P assessment, the firm takes the necessary steps at that time.

There remain a range of practical problems with the Connect system, including:

- In some cases, the system will not allow firms to submit one application for an individual where they hold different roles in different firms. This is due to the system logic that has been designed to reflect certain regulatory limitations that do not apply to every business. A firm may then have to submit two applications and then ensure they are assessed together.
- In some cases, the F&P question sets differ between firms and when a business submits a secondary application, for other firms within the same group, to reflect a role change. We are concerned that this might get worse when the forms are removed from the rulebook.
- The rules apply different prescribed responsibilities depending on the firm and its group businesses where some of those have 'opted up'; however, the incorrect prescribed responsibilities are applied and this results in supplementary information being submitted. The manual documents are not always processed correctly, which results in delays to subsequent applications or notifications as the error must be addressed.

- The statement of responsibilities section does not always populate correctly and brings up the ‘local responsibilities’ section rather than ‘overall responsibilities’.
- Firms report a high number of ‘one-off’ issues that result in lengthy phone calls for the FCA helpdesk to agree manual workarounds or additional information.

Criminal records check

Q13. To what extent to do you agree that the process for obtaining criminal records and notifying these to the regulators is effective in supporting the aims of the SM&CR?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

We invite your views on how this process can be improved.

We support the process for obtaining criminal records as part of the on-boarding process and its value in verifying information provided by a candidate as part of the Fitness and Propriety assessment. It is also a useful tool for ongoing checks to ensure an individual remains fit and proper to carry out their role.

However, the requirement to carry out a criminal record check for every subsequent Form A can be overly burdensome, and significantly increase the amount of work and time required to complete and submit a simple application. This process can be frustrating, particularly during periods of significant change within a business and where multiple applications are being completed for the same individuals in a short time frame. We would question whether repeating these checks after three months adds value, particularly as the F&P questions would have been revisited as part of the application, and would welcome consideration of a longer time frame before which another criminal record check would be required for example, either six or 12 months.

12-week rule

Q14. To what extent do you agree or disagree that the 12-week rule sufficiently helps firms to manage changes in SMFs?

- Strongly agree ☐
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☒

We invite your views and suggestions on how this process can be improved.

We agree that a fixed timescale is appropriate to ensure proper focus is given to managing change. However, the 12-week rule for managing responsibilities in the absence or following the departure of an SMF is too short: six months allows for a more natural recruitment process and avoids the need for firms to make ineffective and unhelpful changes purely to satisfy an arbitrary deadline.

We would welcome guidance on regulatory expectations in terms of the process that should be followed when utilising the '12-week rule'. It appears that different supervisory teams interpret the requirements differently.

Senior Management Functions and Responsibilities

Q15A. To what extent do you agree or disagree that we have in place the correct set of Senior Management Functions to achieve the aims of the SM&CR?

- Strongly agree ☐
- Agree ☒
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

Q15B. To what extent do you agree or disagree that we have in place the correct set of Prescribed Responsibilities to achieve the aims of the SM&CR?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you would like to elaborate on your view, please do so.

The Senior Management Functions are appropriate and this aspect of the regime is well-established and effective. However, one aspect of the regime that does cause confusion is ‘Minimising Overlap’. We do not understand the benefit of the rule, which causes problems, including:

- Not all SMF roles show on the register; this is confusing to individuals and to firms as we cannot verify an individual’s SMFs as part of the recruitment process. The value in excluding them from the register is unclear, particularly as they would still be included as part of an individual’s application and documented within their SoRs.
- The process is inconsistent depending on the order that SMFs are applied for; when a role that is subject to the rule is removed, there is no formal notification process for this.

We would welcome the removal of this rule, with all relevant SMFs showing for any individual on the FCA register and subject to the same processes.

The prescribed responsibilities help provide an indication to individuals and the Board of the various regulatory priorities, including the view of where in the governance hierarchy that they reside. However, as mentioned earlier, the inconsistent application across firm types causes confusion and an unnecessary administrative burden.

We have also seen a tendency for regulators to seek the creation of Board Champions, e.g. on Climate Change and the Consumer Duty. These are not proscribed in the same way, and therefore risk making the structure more complex and duplicative.

Duty of Responsibility

Q16A. To what extent do you agree or disagree that the Duty of Responsibility supports personal accountability?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

Q16B. To what extent do you agree or disagree that the Duty of Responsibility supports better conduct of Senior Managers?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have any suggestions on how the Duty of Responsibility can be improved, please add them below.

The Duty of Responsibility, combined with the conduct rules, provides a robust message to individuals holding Senior Manager Functions and provides clarity on what is expected. However, as with the conduct rules, we would welcome further guidance on their application and examples of how an individual could breach these rules, as currently there is a lack of publicly available information on this.

Statements of Responsibilities and Responsibilities Maps

Q17. To what extent do you agree or disagree that Statements of Responsibilities and Management Responsibilities Maps help to support individual accountability?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have any suggestions for how the Statements of Responsibilities and Management Responsibilities Maps can be improved, please add them below.

The Statements of Responsibilities support individual accountability. Whilst the Management Responsibilities Map does help to articulate these, it would be helpful if PRA/ FCA could publish a standard template to support smaller firms.

Certification Regime

Q18. To what extent do you agree or disagree that the Certification Regime is effective in ensuring that individuals within the regime are fit and proper for their roles?

- Strongly agree ☐
- Agree ☒
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have any suggestions for how the Certification Regime can be improved, (for example, in scope or process, or anything else) please add them below.

The Certification Regime provides a strong foundation to both ensure and evidence that individuals are fit and proper for their roles. A robust process is beneficial to consumers, firms and individuals and can help strengthen the reputation of the industry and individuals within it. The annual review is valuable ensuring that individuals remain fit and proper, and the expanded scope of regulatory referencing helps both firms and individuals, strengthening their position in the market when applying for new roles.

It would be useful for the SMCR to have guidance for the certified cohort on what is expected as part of the annual certification process. There appear to be a wide range of approaches, and we have seen consultants use this to advocate a comprehensive review. We consider a risk-based approach should be adopted.

As mentioned earlier, we would welcome a review of the scope of the certification population, especially in terms of Training and Competence (TC) staff. Whilst we agree with the inclusion of financial advisers, we would question the value of including lower

level staff, for example T&C overseers. Applying two sets of requirements (TC & Certification) to these individuals appears disproportionate, especially when a robust TC scheme should already be in place to evidence the skills, competence and capability of such individuals.

Topics applicable to SMR and Certification Regime

Directory of Certified and Assessed Persons

Q19A. Regarding the Directory of Certified and Assessed Persons, to what extent do you agree or disagree that it captures the correct type of individuals?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

Q19B. Regarding the Directory of Certified and Assessed Persons, to what extent do you agree or disagree that the requirements for keeping it up to date are appropriate?

- Strongly agree ☐
- Agree ☒
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have any suggestions for how the Directory or the process of keeping it up to date can be improved, please add them below.

We agree with the timelines for firms to keep the Directory up to date. We observe though that the Register is not always maintained up to date by FCA, and that changes to responsibilities are not always assigned to the correct individual.

In addition, the ‘Connect’ system limitations can cause additional burdens, such as:

- Many businesses have multiple firms within a group, and an individual is often certified across multiple firms. ‘Connect’ only allows a business to remove a record at firm level, unlike the SMF application which permits changes for multiple firms within the same notification. Additionally the system only allows you to submit one notification per individual at any one time, and a second notification cannot be

submitted until the first has been actioned. For example, Person A is certified on 8 firms and we must submit 8 removals, each a day apart. This results in the final notification being sent outside the regulatory timeframe (assuming the initial notification was actioned on day 1).

- On the rare occasions where there is an inputting error, ‘Connect’ does not allow the removal and replacement of the record. In the past, we have had to contact the FCA Helpdesk who will implement a manual workaround to correct or remove the incorrect record.
- Sometimes the 7 day timeframe can be a challenge and we think firms would benefit if this was extended to 14 days.

Regulatory References

Q20. To what extent do you agree or disagree that regulatory references help firms make better-informed decisions about the fitness and propriety of relevant candidates?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have any suggestions for how the process for providing and obtaining regulatory references can be improved, please add them below.

Regulatory references are a useful part of the on-boarding process, helping to ensure that individuals are fit and proper, as well as verifying information obtained as part of the recruitment process.

The challenge comes with the time taken to obtain references, especially as they often cannot be requested until the individual has formally agreed to accept the role. Internal processes, including F&P have often already started before references are requested and allowing six weeks to reply means an application is ready to submit before the references are received. This wait can considerably lengthen the time taken to submit an application, which then impacts firms through the need to arrange temporary cover for an SMF’s responsibilities until approval is received, as well a considerable amount of additional work. We would welcome consideration of a reduced timeframe for completing regulatory references of 3-4 weeks as we believe that is ample time to collate the information needed.

We would also welcome further clarification or guidance on the approach to regulatory references for consultants who are carrying out an SMF for a firm, but where that individual is employed by a separate consulting firm. In our experience there have been barriers when requesting references for such individuals as they are not managed through the normal HR processes and the time taken to chase these requests further lengthens the on-boarding process.

Conduct Rules

Q21. To what extent do you agree or disagree that the Conduct Rules are effective in promoting good conduct across all levels of the firm?

- Strongly agree ☒
- Agree ☐
- Neutral ☐
- Disagree ☐
- Strongly disagree ☐

If you have any further comments to add on Conduct Rules, please add them below.

The Conduct Rules are an effective deterrent to poor behaviour and, alongside a firm’s disciplinary processes, encourage individuals at all levels to take responsibility for their behaviours.

Firms report finding it difficult in some cases to identify if certain disciplinary cases have breached the conduct rules; we would welcome more guidance and clarity in this area. This is particularly apparent where issues relate to an individual’s behaviours, for example bullying or attitude, rather than the performance of their role. Feedback on the content of the REP008 conduct breach report would also help and give a good indication of whether firms within the industry are consistent and reporting the same sort of data.

Other issues

Q22. Are there other areas, not already covered in the question above, where you consider changes could be made to improve the SM&CR regime?

We consider that alongside the review of SMCR, there is an urgent need to consider the effectiveness of the Appointed Representatives regime. Treasury’s Call for Evidence, which we are also responding to in brief, confirms it will respond to that separate Call for

Evidence in due course. AR's are not covered under SMCR, but the current approach creates lots of work and problems for small providers such as AFM members, due to the movement of advisors across organisations (i.e. phoenixing). We suggest the regime is amended to require individual registration for anyone giving advice, and that directors of advice firms should be covered by fitness and probity rules.

As mentioned earlier, some aspects of the regime seem to add an extra layer or confusion and administrative burdens where the benefit to the customer or the regulator is unclear, for example the 'Minimising Overlap' rule.

In addition, we would welcome a review on whether the PRA application of 'Key Functions' is still necessary, especially when considered in line with the FCA 'Overall Responsibility' requirements. The two elements are similar in certain aspects, but differ greatly in application. This causes confusion for individuals and additional administrative burdens.