SENIOR MANAGERS AND CERTIFICATION REGIME – From threat to opportunity?

A radical change is coming to financial services. The UK's Senior Managers and Certification Regime (SMCR) is one of the strictest personal accountability frameworks in regulated financial services sectors around the world and will upend the way senior management operates. Whilst the new Regime brings about significant change, many of its principles are common sense approaches to running a well-controlled business.

The new Regime aims to create greater clarity on the division of roles and responsibilities, and to promote accountability among senior management within financial services firms. It also seeks to ensure that decision makers easily have available all the information needed to understand the risks pertinent to their roles, and how to manage and mitigate those risks appropriately.

Here we explore some of the pitfalls, opportunities and controversies that the introduction of the UK's Senior Managers and Certification Regime will bring.

Collective and individual responsibility – not contradictory

Whilst seemingly opposing ideas, these two principles should co-exist and should be properly balanced. Senior managers will be required to look in more detail at how key decisions are made and their potential consequences, both within their own area and across the wider business.

The SMCR's intent of strengthening individual accountability without compromising collective responsibility is key, although the reality may be hard to achieve.

Two tier boards – a risk of discord

There is a risk that the changes could see the development of two tier boards as those members with specific accountabilities, such as chairs of board committees, feel under pressure to work more closely with the company's executives and to have a greater direct influence on decisions that affect them personally. This increased involvement risks a loss of independence for those non-executive directors, something that needs to be watched for. Another risk is that other non-executive directors without designated roles become less influential and less engaged.

Further, having identified what they are personally responsible for, board directors could potentially become disengaged from other decisions and events that are not directly relevant to their areas of responsibility. Communication and a sense of shared responsibility could be compromised. It will be for the chair of the board to guard against these potential outcomes.

Removal of reversed burden of proof – a false sense of security

There was considerable relief among senior managers when the removal of the reversed burden of proof for management responsibility was announced. The original SMCR consultation paper contained a proposal that, if something went wrong within a senior manager's area of responsibility, the presumption should be that it was their fault and that the senior manager in question would have to prove otherwise. This proposal provoked substantial controversy.

The removal of the reversed burden of proof has created a false sense of security among many senior managers. The reality is that the situation has not really changed greatly. The 'reasonable steps' requirement still imposes a clearer, and thus heavier, level of accountability, and the same requirement to substantiate actions and decisions.

All reasonable steps – a high bar

Under the new Regime, senior managers will be required to show that all reasonable steps were taken when making a decision, and to evidence these steps. This requirement, and the need to show that they have acted reasonably, sets a high bar and means that senior managers will need carefully to consider the way in which decision-making is governed and prioritised. This will include decisions to delegate and decisions to do nothing.

This change has serious consequences in cases where something goes wrong. The requirement to prove that a senior manager acted "reasonably" is, to a large extent, subjective and may lead to a lengthy legal challenge. However, a court of law is not the ideal environment in which to examine management processes and the business of decision-making. Instead of being asked to consider case law and statute, the Court will likely be asked to consider what constitutes a "reasonable" decision or reasonable steps – issues which will require expert input.

Avoiding decision paralysis – the challenge of record keeping

The requirement for senior managers to show that they have taken all reasonable steps will result in more extensive and detailed written records. In some cases such extensive record keeping could slow day-to-day management and risks leading to the excessive use of outside legal and consultancy input and, at worst, decision paralysis.

For well-run companies this need not be the case. For example, it does not mean that every conversation has to be meticulously documented. What constitutes "reasonable," might well be subjective, but since not every decision carries an equal degree of risk, due diligence and evidencing of decisions need to be similarly proportionate. When it comes to information, this issue is one of quality not quantity – senior managers need to have sufficient and appropriate information. A proportionate yet effective response is needed.

At risk – 'modern' organisational structures

One particular management structure that will be subject to greater risks under the new Regime is the matrix organisation. Common in global banking, this typically involves shared responsibilities for business leadership. Further, many multi-business firms will operate shared service or outsourcing arrangements for critical support functions. Under the SMCR, senior managers are expected to have front to back responsibility – but what happens if they are responsible for sections of the business or associated infrastructure over which they have no direct control?

Here too firms will have to review their management and reporting structures. Firms will need to ensure that senior managers have adequate lines of sight into the areas for which they are responsible. Ultimately, senior managers will need to be comfortable with their accountabilities - it is the firm's responsibility to make sure this happens.

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Governance arrangements – "trust, but verify"

The new Regime can serve as a catalyst for senior managers to reassess their governance arrangements, to take a more strategic view and to make changes where necessary. Senior managers will likely need to reinforce their policy of "trust, but verify." Senior managers should continually be asking themselves: "How do I know that everything is working as I think it is?" and "What evidence can I actually rely on?"

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Talent – recruitment and retention

There is a danger that this new Regime will scare away talent in the firms affected, as potential senior managers become more concerned about the increased personal risk and the severity of actions that could be taken against them.

Senior managers need to increase their due diligence and look more closely at culture, governance, management information and risk management arrangements at their current firm, or before taking on a new role with another firm.

Those companies that can show that they have strong governance and controls, the right decision-making structures, and documentation procedures in place to support senior managers, can gain a competitive advantage when it comes to recruiting and retaining talent.

The brightest and the best will increasingly want to work for companies that will protect them from the risk of being subject to regulatory and even legal action, and where they can develop their talents, and pursue their careers in a safe environment.

Companies that see the SMCR as an opportunity rather than a threat and meet its requirements fully, organising themselves appropriately, and rethink organisation and processes, can also lower their capital requirements to reflect increased control over their operational risk.

Extending the Regime – plan ahead

As the new Regime is rolled out from banking, insurance and investment firms into other parts of the financial services industry from 2018, more firms will find themselves affected by it. Some sectors, in particular consumer credit, may need to invest more time in training and education for their staff on Conduct Rules, as the FCA regulatory regime is still relatively new for those firms.

Whilst the regulators will work to ensure the new Regime is proportionate, the new Regime will still have significant implications on firms' business models and governance arrangements. Implementing such changes will take time and effort and will require a change of mind-set at all levels of management. Therefore firms have no time to lose. They should start planning this now and those affected post 2018 should learn from companies required to implement the SMCR in March 2016.

Things to consider

- Regulators will find it easier to take action against individuals who are viewed as falling short of discharging their responsibilities properly.
- The SMCR may make it difficult for firms to operate certain organisational structures.
- A delicate balance will need to be struck to avoid too much, or too little, involvement from the non-executive directors.
- Organisational cultures and mind-sets may need to evolve to truly embed the new Regime.
- It will be essential to understand and embed what good looks like in all critical areas and, as ever, it will be better to be at least within "the pack" than to be a laggard.

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